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M&A Report – Takeaways from Mindbody Stockholder Litigation

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On March 15, 2023, in an opinion following a lawsuit brought by former stockholders of Mindbody, Inc. (Mindbody) arising out of the 2019 take-private acquisition of Mindbody by Vista Equity Partners (Vista),[1] Delaware Chancellor Kathaleen McCormick found that (1) the former CEO of Mindbody, Richard Stollmeyer, violated his fiduciary duties under *Revlon* by "tilt[ing] the sale process in Vista's favor for personal reasons," (2) Stollmeyer violated his duty of disclosure by "fail[ing] to disclose the full extent of his involvement with Vista, which was a material omission," and (3) Vista aided and abetted Stollmeyer's breach of his duty of disclosure by "failing to correct the proxy materials to include a full and fair description of its own interactions with Stollmeyer." Chancellor McCormick awarded damages equal to $1 per share, plus interest and costs, and held that both Stollmeyer and Vista were jointly and severally liable for the damages.

This case provides several lessons for public company boards and potential private equity buyers in reinforcing the importance of designing and following fair and open sale processes, crafting honest and fulsome proxy disclosures, and being prudent with written communications.

Background

As the Court put it, Stollmeyer had "idiosyncratic reasons" for pursuing a sale of Mindbody that did not align with Mindbody stockholders' interests. Specifically, Stollmeyer wanted to (1) sell fast, (2) sell to a "good home" for "his company" and management team, (3) obtain near-term liquidity and a potential large post-closing equity upside and (4) enter into a lucrative post-closing employment arrangement.

Before initiating any formal sale process, Stollmeyer twice indicated to Vista that he was considering putting Mindbody up for sale – including at Vista's annual summit of its portfolio company executives, during which Stollmeyer texted a colleague that Vista "really love me and I love them." In both instances, Stollmeyer failed to inform the Board of his overtures. Vista subsequently made an oral expression of interest to Stollmeyer to acquire Mindbody in October 2018, after which Vista swiftly kicked off its internal diligence processes to prepare a formal bid. Meanwhile, the Court found that Stollmeyer slow-walked the Mindbody Board by waiting eight days to inform the Board of the proposal to give Vista an edge over other potential bidders.

After learning of Vista's expression of interest in an acquisition, the Board appointed an independent transaction committee to evaluate the transaction, but the Court found that Stollmeyer's conflicts of interests once again infected the process. Stollmeyer knew that Mindbody's largest stockholder, Institutional Venture Partners (IVP), similarly desired a near-term exit, and as a result Stollmeyer pushed for IVP's representative on the Board, Eric Liaw to chair the transaction committee. In turn Liaw, as chair of the committee, pushed to engage the investment bank that connected Stollmeyer to Vista.

Once the formal sales process was initiated, Stollmeyer continued to back-channel with Vista throughout November and early December 2018, giving it a competitive advantage over other potential bidders. It was not until December 15 that Vista and the other financial

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sponsors received access to a Mindbody data room, but by that time Vista already had completed its internal diligence and its investment committee already had approved the Vista deal team to pursue an acquisition. On December 18, just three days after the data room opened, Vista submitted a formal bid to acquire Mindbody for $35 per share. Although the transaction committee's financial advisor prompted Hellman & Friedman (H&F), the last remaining potential competitive bidder, to make a bid, H&F lamented internally that it needed more time and never submitted a bid. On December 20, Vista made a "best and final offer" to acquire Mindbody for $36.50 – a premium of approximately 68% based on Mindbody's December 21 closing stock price – and the merger agreement signed on December 23, 2018.

Legal Analysis

Under Delaware's seminal *Revlon*[2] line of cases, once a company's board of directors decides to put the company up for sale, the board must focus on obtaining the best price reasonably available. When these so-called "*Revlon* duties" are implicated, directors, as fiduciaries, face enhanced scrutiny of their actions during the sale process. Enhanced scrutiny does not apply, however, if the transaction was "approved by a fully informed, uncoerced majority of the disinterested stockholders,"[3] in which case the more deferential business judgment rule applies. Here, the Court found that Stollmeyer was liable under a "paradigmatic *Revlon* claim" and could not escape enhanced scrutiny due to false and misleading disclosures in Mindbody's proxy statement.

Applying *Revlon* to Stollmeyer's action in the sale process, the Court concluded that the decision-making process was not adequate because Stollmeyer was clearly conflicted and "tilted the playing field in Vista's favor" in multiple ways. The Court further found that Stollmeyer's conduct during the sale process was not reasonable and constituted a breach of his fiduciary duties, concluding that "without Stollmeyer's help, Vista would not have gotten [Mindbody] for $36.50 per share." Stollmeyer also did not inform the Board of his conflicts and took steps to deprive the Board of the information needed to employ a reasonable decision-making process. Thus, Stollmeyer could not rely on the Board's actions to support the reasonableness of the sale process.

Further, the Court found that Stollmeyer and Vista kept Mindbody's stockholders as uninformed of their back-channel end-run around the Board's formal sale process as the Board had been. The Court focused the fact that the preliminary proxy statement omitted mention of Stollmeyer's two preliminary meetings with Vista, Vista's verbal expression of interest to Stollmeyer on October 15, 2018, and Stollmeyer's tip to Vista that Mindbody would be running a formal sale process before the sale process began. Although Mindbody filed supplemental disclosures that disclosed the early meetings with Vista and Vista's expression of interest, the Court found the disclosures were "sterilized" at best and outright false at worst. For example, the proxy statement noted that it was "typical" for Stollmeyer to present to potential investors, but the Court found that Stollmeyer had not indicated to any other investors that he wanted to pursue a sale of Mindbody before the initiation of the formal sale process. Notably, the supplemental disclosures still did not disclose that Stollmeyer had tipped Vista. As such, the disclosures amounted to a "false narrative," that Stollmeyer and Vista met casually before the sale process and that Vista only learned of the formal sale process through the same channels as all other potential bidders.

In finding that Vista knowingly aided and abetted Stollmeyer's breach of his duty to disclose, the Court noted that Vista had negotiated for the right to review and comment on any Mindbody proxy materials and that Vista had the obligation to inform Mindbody of any material misstatements or omissions in the proxy materials it became aware of. Yet, the Court found that Vista reviewed multiple versions of the preliminary proxy statement and the supplemental disclosures and approved the language despite the disclosures being misleading and incomplete.

The Court also found that Vista knew the omissions and misstatements were material and

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took active steps to obscure the tilted nature of the sale process. An early draft of Vista's investment committee deck noted that Vista had been informed of Mindbody's sale process in "late October," but the final deck adjusted the date to November 30 – when the transaction committee's financial advisor formally reached out to Vista. Between the drafts, a senior member of the Vista deal team texted the drafter of the deck stating, "don't tell them about process." Similarly, an earlier draft of the investment committee deck noted that Stollmeyer informed Vista at the August 2018 meeting that he wanted to put Mindbody up for sale, but the final version of the deck simply stated that Stollmeyer met with a Vista representative.

To remedy these breaches, the Court awarded damages to the stockholder plaintiffs equal to $1 per share based on what Vista would have been willing to pay had a fair process been conducted. The Court focused on the fact that Vista deal team members took bets on what the deal price would be, and two of Vista's most informed deal team members bet the deal price would be $37.50. Thus, the Court found, "the evidence demonstrates that Vista would have paid $37.50 had Stollmeyer not corrupted the process."

Lessons Learned

1) **Designing and following a fair and open sale process is critical for both public company fiduciaries and potential buyers**. The Court's decision reinforces the importance of boards and their transaction committees having ultimate control over a sale process and insisting on full transparency on interactions with potential bidders. And although the Court did not find Vista liable for aiding and abetting Stollmeyer's *Revlon* violations because plaintiffs failed to timely raise such a claim, the Court nonetheless faulted Vista for participating in the scheme to end-run the sale process. Accordingly, private equity bidders should be mindful of following the established procedures in a sale process and be proactive in ensuring that the parties they are negotiating with have been authorized to do so and are reporting back to the full board or transaction committee.

2) **Parties must be cognizant of avoiding pitfalls where the interests of management, large insider stockholders and the remaining disinterested stockholders may diverge**. A related concern is that the interests of incumbent management and other stockholders who will have a continuing interest in the post-transaction company inherently will diverge from the interests of disinterested stockholders who are being cashed out in the transaction. This is particularly relevant to private equity bidders in take-private transactions, which often involve post-closing leadership roles for incumbent management and require large stockholders, including incumbent management, to "roll-over" a portion of their equity stake into the post-closing privately held company. To the extent possible, private equity bidders generally should avoid discussing post-closing roles and compensation with management at least until a purchase price has been agreed with the target board. And although not specifically raised in the Mindbody case, in transactions involving equity rollovers by management directors or other stockholders with board representation, both target boards and private equity bidders should also ensure that a committee of disinterested directors with its own advisors is established to negotiate and approve the transaction, with a majority of disinterested stockholders also potentially approving the transaction depending on the facts and circumstances.

3) **Proxy disclosures should not omit or obscure any material communications between a target and potential buyer.** Even though a proxy statement is sent by a target company to its stockholders, a private equity buyer in a take-private acquisition will generally have the obligation to ensure that the disclosures in the proxy statement regarding the material communications and interactions between the buyer and the target company or its management are truthful and accurate, and may face liability if it fails do so.

4) **Potential private equity buyers should be mindful of internal price deliberations, which may become the basis for a future damages calculation, and other internal**

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communications, which may become the basis for potentially embarrassing or damaging disclosure. Just as public company target boards are consistently reminded to be careful with written communications and to assume that all written communications will be discovered as part of litigation, private equity bidders should be careful with any written record they create, including emails, text messages, internal presentations and other written materials. In finding that Vista was liable for aiding and abetting Stollmeyer's disclosure violations, the Court relied in large part on this written record, including Vista's after-the-fact attempts to cleanse the record through later drafts of documents.

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[1] *In re Mindbody, Inc. Stockholder Litigation,* C.A. No. 2019-0442-KSJM, memo. op. (Del. Ch. Mar. 15, 2023).

[2] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

[3] *Corwin v. KKR Fin. Holdings, LLC, 125 A.3d 304, 305–06 (Del. 2015).*

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Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this update. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Mergers and Acquisitions, Private Equity, or Securities Regulation and Corporate Governance practice groups, or the following practice leaders and members:

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