M&A Insights: Leveraged Acquisition, Mindbody Decision, & Fiduciary Duties

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Today’s Panelists

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Daniel Alterbaum is a partner in Gibson, Dunn & Crutcher’s New York office and is a member of the firm’s Mergers and Acquisitions and Private Equity Practice Groups. Mr. Alterbaum has been recognized as a “Rising Star” by New York Metro Super Lawyers in the area of mergers and acquisitions from 2015-2022, as well as by The Deal. He represents buyers, sellers and investors in a wide variety of transactions in the private equity, fintech, renewable energy and infrastructure sectors. His experience includes leveraged buyouts, negotiated sales of private companies, carve-out sales and spinoffs of subsidiaries and cross-border asset sales. He also represents issuers and investment funds in connection with venture capital, growth equity and structured preferred equity investments.

Quinton C. Farrar

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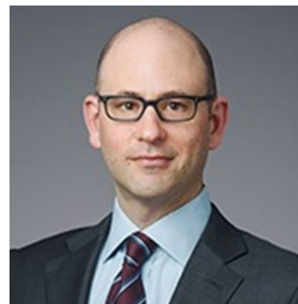

Douglas S. Horowitz

Douglas S. Horowitz is a partner in Gibson, Dunn & Crutcher’s New York office. Mr. Horowitz is the Head of Leveraged and Acquisition Finance, Co-Chair of Gibson Dunn’s Global Finance Practice Group, and an active member of the Capital Markets Practice Group and Securities Regulation and Corporate Governance Practice Group. Mr. Horowitz has been recognized as a leading finance lawyer by Chambers USA, Chambers Global, The Legal 500 and Euromoney’s IFLR 1000: The Guide to the World’s Leading Financial Law Firms. Mr. Horowitz represents leading private equity firms, public and private corporations, leading investment banking firms and commercial banks with a focus on financing transactions involving private credit, syndicated institutional and asset based loans, new issuance of secured and unsecured high-yield debt securities, equity and equity-linked securities, as well as out-of-court restructurings.

Robert B. Little

Robert B. Little is a partner in Gibson, Dunn & Crutcher’s Dallas office, and he is a Global Co-Chair of the Mergers and Acquisitions Practice Group. Mr. Little has consistently been named among the nation’s top M&A lawyers every year since 2013 by Chambers USA. His practice focuses on corporate transactions, including mergers and acquisitions, securities offerings, joint ventures, investments in public and private entities, and commercial transactions. Mr. Little has represented clients in a variety of industries, including energy, retail, technology, infrastructure, transportation, manufacturing and financial services. Mr. Little is admitted to practice in the state of Texas.

Brennan Halloran

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Leveraged Acquisition

Highly *Levered Acquisition* Finance: Current Trends

- Large Cap Transactions
  - Private Debt vs. Syndicated Solutions vs. Pro Rata Bank Markets
  - Loans vs. Bonds
  - Portability when possible
  - Junior Capital
- Middle Market Transactions
  - Private Debt vs. Pro Rata Bank Markets
  - Preferred Equity
- Capital Structures
  - Leverage Levels
  - Minimum Equity Conditions
- Implications for Carve-outs
- Maintenance Covenants
- Rate Hedging

Mindbody Decision

Lessons from the *Mindbody* Decision: Overview

- 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, Delaware Chancellor Kathaleen McCormick found that:
  - the former CEO of Mindbody, Richard Stollmeyer, violated his fiduciary duties under *Revlon* by “tilt[ing] the sale process” in the private equity buyer’s favor “for personal reasons,”
  - Stollmeyer violated his duty of disclosure by “fail[ing] to disclose the full extent of his involvement” with the buyer; and
  - The buyer 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 the buyer were jointly and severally liable for the damages

Lessons from the *Mindbody* Decision: 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 the buyer that he was considering putting Mindbody up for sale
- Once the formal sales process was initiated, Stollmeyer continued to back-channel with the buyer throughout November and early December 2018, giving it a competitive advantage over other potential bidders
- On December 18, just three days after the data room opened, the buyer submitted a formal bid to acquire Mindbody for $35 per share

Lessons from the *Mindbody* Decision: Legal Analysis

- Under the *Revlon* standard, 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
  - 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 favor of the buyer in multiple ways
- The court also found that the buyer aided and abetted Stollmeyer's disclosure breach
  - The buyer reviewed multiple versions of the preliminary proxy statement and the supplemental disclosures and approved the language despite the disclosures being misleading and incomplete

Lessons from the *Mindbody* Decision: Lessons Learned

- Designing and following a fair and open sale process is critical for both public company fiduciaries and potential buyers
- Parties must be cognizant of avoiding pitfalls where the interests of management, large insider stockholders and the remaining disinterested stockholders may diverge
- Proxy disclosures should not omit or obscure any material communications between a target and potential buyer
- Potential private equity buyers should be mindful of internal price deliberations, which may become the basis for a future damages calculation, and other internal communications, which may become the basis for potentially embarrassing or damaging disclosure

Fiduciary Duties

[McDonald's Corp. and D&O Indemnification Matters]

The Background of the Derivative Action: Context

- In *McDonald's*, the Delaware Court of Chancery held that corporate officers owe a duty of oversight akin to that owed by directors under the seminal 1996 *Caremark* decision
- The company's stockholders brought a derivative action on behalf of the corporation against the company's former Executive Vice President and Global Chief People Officer, alleging that he breached his fiduciary duties to the company by consciously ignoring red flags regarding sexual misconduct and failing either to address those red flags or escalate them to the board or CEO
  - He also was alleged to have engaged in sexual misconduct himself
- The Court rejected the officer's argument that Delaware law does not impose *Caremark* obligations on an officer of the company

The Shifting Landscape on Officers Liabilities: Court Decision

- The Court held that officers owe *Caremark* duties that include the duty of oversight, which itself derives from the duty of loyalty
- For a *Caremark* claim to succeed, the plaintiff must prove that:
  - (1) the director or officer "utterly failed" to implement any reporting or information system or controls, or
  - (2) the director or officer "consciously failed" to monitor or oversee such reporting system and thus was disabled from being informed of risks or problems requiring attention.
- For relevant and timely information to reach the board, the officers who serve as the day-to-day managers of the entity must make a good faith effort to ensure that information systems are in place so that the officers receive relevant and timely information that they can provide to the directors."

Impact on D&O Insurance: Effect on Current Policies

- Many practitioners do not expect *McDonald's* to materially affect premiums because stockholders looking to bring a derivative claim against a corporate officer must first satisfy a demand requirement (*i.e.*, they must make a demand on the company's board to investigate their claim and potentially file suit against the officer)
  - Only after the board declines the demand can stockholders file a derivative suit
- If the company's board has already been implicated and stockholders have already brought a claim against the board, *McDonald's* is also unlikely to result in new litigation that would have an impact from a D&O coverage perspective
- Demonstrating "futility" (*i.e.*, the board cannot make an impartial decision as to whether to bring a suit and therefore sue the company's officers) remains difficult
- *McDonald's* also requires demonstrating that the officer did not act in good faith, meaning that derivative claims must prove that the relevant officer knew that the officer was not satisfying such officer's oversight duties—a difficult claim to sustain

Impact on D&O Insurance: Possible Knock-on Impacts

- By the same token, *McDonald's* did hold that an officer's engagement in behavior that violates the law or their own oversight responsibilities can be a bad faith breach of fiduciary duty
  - Vice Chancellor Laster characterized the relevant officer's actions as "reprehensible conduct for selfish reasons" and in perpetrating those acts, the harasser "acts in bad faith and breaches the duty of loyalty."
- As a result, incidents that previously would have only resulted in claims under non-D&O policies (*e.g.*, sexual harassment as an employment discrimination or harassment claim) might now also result in derivative actions
- In addition, even if stockholders cannot make a showing of demand futility, investigating such demands can be expensive and the costs of such investigations could lead to claims under a directors and officers policy (as in the case of Side D coverage, where some reimbursement of such expenses may be provided)

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