To Our Clients and Friends,

The March edition of our Insurance Industry Corporate Governance Newsletter focused on the impact of the sudden downfall of Silicon Valley Bank and Signature Bank, and in particular the likely impact of those receiverships on the insurance industry.

This month's edition focuses on a recently announced decision of the Delaware Court of Chancery that illuminates the court's view of M&A processes in the *Revlon* context.

Under *Revlon* (*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*., 506 A.2d 173, 175 (Del. 1986), in the context of the sale of control of a company for cash, "directors are generally free to select the path to value maximization, so long as they choose a reasonable route to get there," and the question boils down to whether they have exercised their powers "in the service of a specific objective: maximizing the sale price of the enterprise." To satisfy enhanced scrutiny under *Revlon*, defendants generally bear the burden of demonstrating both (i) the reasonableness of the decision making process employed by the directors, including the information on which the directors based their decision and (ii) the reasonableness of the directors' actions in light of the circumstances then existing. Under later Delaware law, that burden can be shifted where a sale has been approved by the vote of a "fully informed, uncoerced majority of the disinterested stockholders." *Corwin v. KKR Fin. Hldgs. LLC, 125 A.3d 304, 305–06 (Del. 2015).*

The new case is *In Re Mindbody, Inc., S'Holder Litig.*, C.A. No. 2019-04420KSJM (Del. Ch. March 15, 2023). *Mindbody* explores the risks to a target company's management of giving a private equity sponsor pole position in a sale process, as well as the risks to the sponsor itself from pursuing an inside track.

This case is highly relevant to boards and management of publicly traded insurance groups who may consider a sale of the company to a private equity sponsor among the strategic alternatives available to them.

Delaware Chancery Court Ruling *In Re Mindbody, Inc., S'Holder Litig.*

Private equity sponsors compete for acquisition targets, with one of their principal tools being the speed with which they can move. The *Mindbody* case illustrates that *Revlon* is alive and well in Delaware, while also adding to the cases suggesting that a desire for near-term liquidity can create a disabling conflict of interests.

In the *Mindbody* case, following a trial, the court held Richard Stollmeyer, the CEO of Mindbody, Inc., liable under *Revlon* for failing to pursue the best transaction reasonably available in connection with Mindbody's 2018 sale to Vista Equity Partners. The court also held Stollmeyer and the sponsor jointly and severally liable for damages for disclosure violations in connection with the sale. The damages—calculated in part based on the court's review of the sponsor's internal modeling—amounted to $1 per share for each of the *Revlon* claim and the disclosure claims, or approximately $44 million in the aggregate, plus pre- and post-judgment interest and litigation costs.

The court found that Stollmeyer was motivated by the liquidity a sale would bring, as he had 98% of his net worth tied up in Mindbody stock and could sell only small amounts under a 10b5-1 plan, which he likened to “sucking through a very small straw.” Stollmeyer also felt pressure from a sunset provision in the high-vote Class B stock he held, which entitled him to 19.8% of Mindbody’s vote but would convert in 2021 to single-vote stock carrying less than 4% of the vote.

Mindbody’s largest stockholder, a venture capital firm with approximately 24.6% of the vote, also faced pressure from the same sunset provision and was looking for an exit. The venture capital firm’s partners were targeting at least $200 million of liquidity by the end of 2018, and Mindbody had been identified as one of five positions that would help meet the goal.

During the summer of 2018, Stollmeyer discussed a possible sale transaction with a banker at Qatalyst, who connected Stollmeyer with Vista and, a week later, with two other private equity sponsors, although Stollmeyer did not meet with those firms until mid-October and early November. In August, Stollmeyer met with Luxor, a 14% stockholder and the plaintiff in this case, to see if it would support a sale. Luxor said it was not interested in a near-term sale. On September 4, Stollmeyer met with Vista, telling them he was looking for a “good home” for his company. All of this took place without any discussion by the Mindbody board.

On October 9, Stollmeyer attended Vista’s “CXO Summit” for CEOs of formerly public Vista portfolio companies. Stollmeyer was “blown away” by presentations illustrating the wealth creation for CEOs of companies taken private by Vista. After the CXO Summit, Stollmeyer became “laser focused” on a sale to Vista. A week later, Vista called Stollmeyer to express interest in a transaction. Stollmeyer claimed at trial that he told Vista the company was not for sale and that he would relay Vista’s interest to the board—but the court did not credit this testimony.

On October 17, Stollmeyer informed his management team of Vista’s interest, telling them he planned to socialize it with the board over the next week. The following day, Stollmeyer told the venture capital firm’s representative on the Mindbody board about Vista’s interest, but he didn’t begin to inform the rest of the board until almost a week later. On October 26, the Mindbody board met to discuss forming a transaction committee. While the transaction committee adopted guidelines to deal with conflicts, including a requirement for its approval for management to communicate with potential bidders, those guidelines were ignored by Stollmeyer.

On November 6, Mindbody missed its third quarter revenue targets and lowered its guidance, causing its stock to drop by 20%. That evening, Qatalyst told Vista that Stollmeyer “wants 40 min,” apparently referring to Stollmeyer’s expectation of a sale price of at least $40 per share. Stollmeyer notified Vista on November 10 that Mindbody would be running a sale process. On November 14, the transaction committee hired Qatalyst as its banker. Although Qatalyst planned to approach strategic bidders beginning November 19 and financial sponsors beginning November 30, Vista was already sprinting towards a transaction, having previously commissioned—with Stollmeyer’s consent—an outside market study of Mindbody.

Vista received its market study on December 13, before any other potential bidders received data room access. On December 18, Vista made a formal bid at $35 per share, with a 24-hour deadline for acceptance. After Mindbody countered at $40 per share, Vista bumped up to $36.50, which the board accepted on December 21. Two days later, the parties signed a merger agreement, and Stollmeyer texted his financial advisor: “Vista’s in love with me (and me with them). No retirement in my headlights.” An internal Vista email described how Vista was “able to conduct all of our outside-in work before the process launched,” enabling Vista “to move swiftly in the process to provide … a highly certain offer within 3 days of receiving data room access.”

The merger agreement included a 30-day go-shop. Halfway through the go-shop period, Stollmeyer took a vacation, emailing management to decline management presentations "[u]nless it's urgent." The go-shop did not elicit a competing bid.

The proxy statement for the deal omitted references to Stollmeyer's initial meeting with Vista, his attendance at the CXO Summit and the October 15 expression of interest. Luxor filed a Schedule 13D stating that the merger undervalued Mindbody and filed a Section 220 demand seeking, among other things, information about fourth quarter performance. Although Mindbody meaningfully exceeded the analyst consensus revenue target, the company, after consulting with Vista as required under the merger agreement, decided not to disclose its fourth quarter results. Litigation ensued.

The court reviewed the numerous competing legal standards potentially applicable to its review of the sale process, including enhanced scrutiny under *Revlon* and the possibility that *Corwin* would cleanse the transaction if the stockholder vote was properly informed; the possibility that Stollmeyer committed "fraud on the board," justifying entire fairness review; the possibility that Stollmeyer committed common law or equitable fraud; and the possibility that disclosure violations themselves could be a source of liability as breaches of the duty of candor. The court likened the parties' positions to a "choose-your-own-adventure story, where all of Plaintiffs' adventures lead to liability and all of Stollmeyer's adventures lead to exoneration."

The court, settling on enhanced scrutiny under *Revlon* as the appropriate standard, found that Stollmeyer's conduct leading to the merger fell outside the range of reasonableness and that the disclosure deficiencies made *Corwin* unavailable to cleanse the transaction.

According to the court, the case presented a "paradigmatic" *Revlon* claim: Stollmeyer suffered a disabling conflict as a result of his interest in near-term liquidity as well as his expectation of lucrative post-merger employment by what would be a Vista portfolio company. According to the court, this led Stollmeyer to tilt the sale process by driving down Mindbody's stock price and giving Vista informational and timing advantages over other bidders. The court also found that the board, unaware of Stollmeyer's conflicts, failed adequately to manage them.

The court did not permit plaintiffs to advance a claim against Vista for aiding and abetting the sale process-related fiduciary duty breaches because plaintiffs failed to plead that claim until after trial. The court did hold, however, that Vista, which had a contractual obligation to correct any omissions in the proxy materials, aided and abetted the disclosure violations, which the court found to be an independent source of liability for both Vista and Stollmeyer—in addition to making their *Corwin* defense inapplicable.

Conclusion

While successful *Revlon* claims are rare, the decision holding Stollmeyer liable for privileging his personal interests over his duties to Mindbody's stockholders is unsurprising given the factual findings of the court.

The decision is more notable, though, as a cautionary lesson for financial sponsors: gaining the inside track and sprinting to the finish is a successful strategy only if that track doesn't result from disloyal actions of target company fiduciaries.

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