Delaware Supreme Court Upholds CEO Fiduciary Duty Liability but Reverses Aiding and Abetting Liability of Private Equity Buyer

In *In Re Mindbody Inc., Stockholder Litigation* (December 2, 2024), the Supreme Court of Delaware (the "Court") upheld an earlier ruling by the Delaware Court of Chancery regarding the defendant CEO's liability for breaching his fiduciary duties during a company sale process. However, the Court's *en banc* panel reversed the Court of Chancery's finding that the private equity purchaser had aided and abetted the CEO in his breach of his duty of disclosure due to the lack of the purchaser's "knowing participation" in the breach.

Background

Richard Stollmeyer, the founder and CEO of Mindbody Inc. ("Mindbody"), was looking to sell his super-voting Class B shares. At the time, his Class B shares represented the second largest block of voting power in Mindbody. The shares would automatically convert into shares of common stock in October 2021, resulting in a significant dilution to his voting power. Mindbody's largest stockholder at the time, IVP, was also considering an exit from the company. Stollmeyer and IVP together controlled over 44% of Mindbody's voting power.

The Court of Chancery held that Stollmeyer began facilitating a "flawed sales process" of Mindbody without board authorization and gave the board of Mindbody (the "Board") incomplete information about his desired exit and the extent of his communications with Vista Equity Partners Management LLC ("Vista"), his preferred potential acquirer. The Board eventually began a formal sales process following Vista's delivery of a formal expression of interest and ultimately accepted Vista's bid. The merger agreement, signed in December 2018, provided Vista with certain rights and obligations, including with respect to proxy materials of Mindbody, including a contractual right to review the proxy materials prior to their dissemination to stockholders, and an obligation to notify Mindbody if it became aware of any facts that would render such proxy materials materially misleading or incomplete.

Certain Mindbody stockholders filed a lawsuit in June 2019 challenging the validity of the stockholder vote ahead of the merger and an appraisal action post-closing, alleging breaches of fiduciary duties.

On March 15, 2023, the Court of Chancery issued its post-trial opinion, finding that:

- Stollmeyer breached his fiduciary duties under *Revlon* by "tilt[ing] the sale process in Vista's favor for personal reasons,"
- Stollmeyer also breached his duty of disclosure by not fully disclosing the extent of his relationship with Vista, constituting a material omission, and
- Vista aided and abetted the breach of duty of disclosure by failing to correct the proxy materials they reviewed.

The Court of Chancery awarded damages equaling $1 per share. The defendants appealed the decision.

Court's Analysis

The Court affirmed the holding that Stollmeyer breached his (i) fiduciary duty of loyalty under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) by favoring Vista in the sales process at the expense of maximizing stockholder value and (ii) fiduciary duty of disclosure by allowing material omissions in the proxy materials. The Court also affirmed the award of damages for Stollmeyer's breaches. However, the Court reversed the finding that Vista aided and abetted the disclosure breach.

In affirming the breach of fiduciary duty of loyalty under *Revlon*, the Court highlighted the key elements of the *Revlon* enhanced scrutiny review, requiring both establishing reasonableness of the decision-making process by directors, including the information on which they base their decision, and reasonableness of the directors' action in light of existing circumstances. The Court agreed with the trial court's examination of Stollmeyer's "subjective intent" and his conflicts in the sale, as well as the trial court's findings that Stollmeyer tilted the sale process to favor Vista, and that the Board had been deprived of the information it needed to undertake the decision-making process required under *Revlon*. The Court also agreed with the trial court's rejection that the defense under *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015) should apply. Under *Corwin*, application of the business judgment rule standard of review can be restored if a transaction not involving a controlling stockholder was approved by a fully informed and uncoerced vote of disinterested stockholders. However, because Stollmeyer kept material information from the Board, the Board could not fully inform stockholders before the vote, and as such, *Corwin* cleansing was not available.

In affirming the disclosure breach, the Court agreed with the trial court that there were material omissions in the proxy materials because of Stollmeyer's breach of the duty of disclosure. In particular, the Court found that tips given by Stollmeyer to Vista regarding Mindbody's future sale process would be found by any reasonable stockholder to be important in considering how to vote in terms of the merger and, as such, were material.

However, the Court found that the trial court erred in finding that Vista aided and abetted Stollmeyer's breach of disclosure. The Court relied on the aiding and abetting four-part test in *Malpiede v. Townson*, 780 A.2d 1075 (Del. 2001), requiring:

- the existence of a fiduciary relationship,
- a breach of the fiduciary's duty,
- knowing participation in such breach, and
- damages proximately caused by the breach.

The trial court divided the third prong into two parts, knowledge and participation, and concluded that Vista acted with *scienter* to satisfy the first component and "participated" in the disclosure breach. The Court disagreed. In *RBC Cap. Mkts., LLC v. Jervis*, 129 A.3d 816, the Court held that to prove *scienter* in an aiding and abetting claim, the plaintiff must demonstrate that the aider and abettor both knew the primary party had breached its duty and that its own conduct regarding the breach was legally improper. While the Court agreed with the trial court that certain changes of Vista's internal records may indicate some awareness that its actions were suspect, there was no finding that Vista knew its failure to notify Mindbody of the omissions in the proxy was wrongful and could subject Vista to liability to Mindbody's stockholders.

Regarding Vista's participation, the Court relied on Delaware trial courts' holdings and reasoning under tort law in stating that participation requires that the aider and abettor provide "substantial assistance" to the primary party. The Court of Chancery has previously held that a party was not liable for mere "passive awareness" of an omission and has implied a requirement of active participation. Analyzing Vista's participation in "the clearest instances" of Stollmeyer's breach of his disclosure duty in omitting information regarding Stollmeyer's tips to Vista, the Court found that there was no factual finding that Vista had actively contributed to the drafting or editing of the proxy materials. Since Vista "took no action" to assist Stollmeyer in his breach of disclosure but was instead a passive bystander of such breach, Vista did not "substantially assist" in the breach.

Further, the Court concluded that a contractual obligation between a target corporation and a third-party buyer to notify the other party of disclosure violations does not create an independent duty of disclosure between such buyer and the stockholders of the corporation such that there may be liability for aiding and abetting. The Court also cites public policy reasons for its conclusion, explaining that the finding of such an independent duty would collapse the arms' length between a third-party buyer and a target and force the buyer to consider its duty to the target's stockholders, rather than to its own.

Our Take

This case reiterated key elements of fiduciary duties in a sale of control and provides insight into Delaware views on aiding and abetting claims in M&A transactions.

In Re Mindbody also serves as a reminder of the process that a board of directors and large stockholders have to follow to satisfy their fiduciary duties. The Court's affirmation of Stollmeyer's breach of the duty of disclosure and the unavailability of a *Corwin* defense sheds light on the consequences of omitting material information in a transaction not just from stockholders, but from a board of directors itself.

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Key Contacts

George Casey
Global Chairman of Corporate
New York
+1 212 903 9300
george.casey@linklaters.com

Elena Rubinov
Partner
New York
+1 212 903 9051
elena.rubinov@linklaters.com

Clara Pang
Partner
New York
+1 212 903 9436
clara.pang@linklaters.com

Josh Feit
Counsel
New York
+1 212 903 9185
joshua.feit@linklaters.com

Andreina Lamas
Associate
New York
+1 212 903 9332
andreina.lamas@linklaters.com

Heiko Schiwek
Partner
New York
+1 212 903 9599
heiko.schiwek@linklaters.com

Gregory Gewirtz
Partner
New York
+1 212 903 9502
gregory.gewirtz@linklaters.com

Pierre-Emmanuel Perais
Partner
New York
+1 212 903 9046
pierre-emmanuel.perais@linklaters.com

Yiting Du
Counsel
New York
+1 212 903 9217
yiting.du@linklaters.com

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