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# *Delaware Court Imposes Price Bump Damages for* Revlon *Sales Process and Disclosure Violations and Related Aiding and Abetting Claims*

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On March 15, 2023, Chancellor McCormick of the Court of Chancery in Delaware issued a post-trial opinion in a stockholder class action imposing liability upon a founder and CEO ("CEO") for breaching *Revlon* sales process duties in connection with the sale of Mindbody, Inc. ("the Company") as well as disclosure duties in connection with the sale.[1] Separately, the Court found the private equity buyer ("Acquirer") liable for aiding and abetting the proxy disclosure breaches. In light of the disclosure breaches, defendants could not avail themselves of business judgment rule protection under *Corwin* and the Court found that the CEO could not survive enhanced scrutiny under the *Revlon* standard of review. Finding that the record demonstrated that the Acquirer would have paid at least $1 per share more for the Company, the Court found the CEO and the Acquirer jointly and severally liable for damages representing $1 per share over and above the negotiated deal price of $36.50 (representing a 2.7% increase), together with pre- and post-judgment interest.

### Background

According to the Court, in 2018 the CEO had grown frustrated with his inability to monetize his holdings of Company stock and was fearful of public markets volatility among other factors. Accordingly, he decided it was a good time to sell the Company. Unfortunately, according to the Court, with the assistance of a banker, he effectively set the sale process in motion largely without the involvement or knowledge of the Company's Board. He participated in several initial meetings and communications with the Acquirer and, according to the Court, "quickly came to believe that selling" to that Acquirer "gave him the unique opportunity to both gain liquidity and remain as CEO in pursuit of post-acquisition equity-based upside." The CEO quickly became focused not merely on selling, but selling to that particular Acquirer on a truncated timeline. The Court found that despite the banker's advice about the risks of rushing the sales process, the CEO "effectively greased the wheels" for the Acquirer by stalling any Board process; the CEO "did not adequately involve the Board or erect, much less adhere, to speed bumps to ensure a value-maximizing process."[2]

It was not until well after giving the Acquirer a substantial head start that put the Acquirer "in a position to make a firm offer before other bidders could react" that the CEO "started dribbling out messages" about the Acquirer's expression of interest to other Board members. The Board was unaware of the full extent of the CEO's "courtship" with the Acquirer and did not form a transaction committee to consider running a sales process until another two weeks later. The same banker who introduced the CEO to the

Acquirer was hired to represent the committee. While the committee established guidelines to cabin management's communications with potential bidders, the CEO ignored them and tipped off the Acquirer that a formal process was beginning.[3] The Court also found that the banker tipped the Acquirer as to the CEO's target price. The Acquirer promptly made a firm offer, and while the Board asked other bidders to respond promptly with best-and-final offers, they were still in early stages of analysis so could not respond within the stated timeframe. Following a Committee counter, the Acquirer raised its bid "to $1 per share below where its deal team thought the deal price would land" and the Board approved that revised offer without making any further counter.[4] This class action ensued and all defendants except the CEO and the Acquirer settled before trial.

## The Decision

As both an officer and director of the Company, the CEO owed fiduciary duties of loyalty and care to the corporation and its stockholders in both capacities. In this class action litigation, plaintiffs claimed that the CEO breached those duties by tilting the sales process in the Acquirer's favor and by failing to disclose material information related to the Merger.

In change-of-control all-cash merger transactions such as this, enhanced *Revlon* scrutiny remains the presumptive standard of review. In that setting, the Board's objective is to maximize the sale price of the enterprise (in recognition that there is no tomorrow for stockholders who are being cashed out). Under *Revlon,* directors generally remain free to select the path to such value maximization, as long as they choose a reasonable route to get there. Thus, *Revlon* enhanced scrutiny involves (a) a judicial determination as to the adequacy of the decision-making process employed by the Board, and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances, and the defendant fiduciaries bear the burden of proof on these elements. While defendant fiduciaries sometimes can invoke the *Corwin* doctrine to lower the standard to an irrebutable version of the business judgment rule, to do so requires that the transaction was approved by a fully-informed, uncoerced majority of the disinterested stockholders, and a single disclosure deficiency will defeat *Corwin* cleansing. Because the CEO was found to have failed to disclose material information about the transaction, the Court found that *Corwin* cleansing was not available and that *Revlon* enhanced scrutiny applied and could not be overcome.[5]

The Court found that the CEO was motivated to sell for idiosyncratic reasons, and wanted both near-term liquidity and the potential for personal post-closing upside. As the Court noted, the CEO "did not strive in good faith to pursue the best transaction reasonably available. He instead pursued a fast sale to [the Acquirer] to further his personal interest. Because he tilted the sale process in [the Acquirer's] favor for personal reasons, the process did not achieve a result that falls within the range of reasonableness."[6] The Court also stressed that the CEO did not have Board authorization when he engaged with the Acquirer to explore the possibility of a sale, and that by delaying before informing the Board, the CEO postponed formal commencement of a sale process and gave the Acquirer the significant advantage of a head start, which skewed the ultimate sales process to obvious effect.[7] The Court also found that the Board did not know about, and thus could not manage, numerous conflicts that infected the sales process, including the CEO's desire for liquidity and a near-term exit, the CEO's various interactions with and preferences for the Acquirer, and the Acquirer's substantial head start.[8]

Similarly, the stockholders were not made aware of the CEO's conflicts and interactions or the way in which the process favored the Acquirer. The Court found that the CEO "knowingly withheld information from the stockholders by painting his interactions with [the Acquirer] in a sterile light." Accordingly, in

addition to the sales process fiduciary violations, the Court found that the CEO also breached his fiduciary duties of disclosure in connection with the inadequate process-based proxy disclosures.[9]

The Court also found that the Acquirer was liable for aiding and abetting those fiduciary disclosure breaches. The Court found that the Acquirer was contractually obligated to review the proxy materials and inform the Company if there were material omissions, that the Acquirer knew the significance of the omitted information and failed to correct the proxy materials to include a full and fair description of its interactions with the CEO, and that it knowingly participated in the disclosure breach "by not speaking up." The Court held that the Acquirer had an obligation to correct the material omissions but failed to do so.[10]

In considering a damages award, the Court acknowledged that the record reflected that the Acquirer had authority to bid up to $40 per share (which plaintiffs sought), but the Court found the most compelling evidence suggested that the Acquirer expected to pay $37.50 per share, or $1 per share above the negotiated $36.50 per share sale price. Accordingly, the Court awarded the stockholders lost-transaction damages in the amount of $1 per share, together with pre- and post-judgment interest and costs, for which the CEO and the Acquirer were found to be jointly and severally liable.[11]

## Conclusion

While *Revlon* enhanced scrutiny has been around for a long time, this recent trial decision highlights that it remains alive and well. A central element of *Revlon* analysis focuses on smoking out conflicts and pretextual justifications for a sale, and early and fulsome disclosure to the Board of material issues remains important to allow the Board to manage such conflicts and any sales process. Similarly, it is important that interested fiduciaries and management refrain from getting out ahead of the Board and that any such process be run by or under the direction of the Board. Finally, disclosures to stockholders should be viewed carefully to ensure that material information is being disclosed, and buyers should consider whether they must speak up to correct known material omissions in proxy disclosures.

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1 *In re Mindbody Inc., Stockholder Litig.*, 2023 WL 2518149 (Del. Ch. Mar. 15, 2023).
2 *Id.* at *1.
3 *Id.* at *2.
4 *Id.*
5 *Id.* at *33.
6 *Id.* at *2, 33.
7 *Id.* at *37.
8 *Id.* at *38-39.
9 *Id.* at *40.
10 Id. at *43-44.
11 *Id.* at *44-48.

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