

In re Chesapeake Shareholder Derivative Litigation

COURT: District Court of Oklahoma County, State of Oklahoma
CASE NUMBER: CJ-2009-3983
CASE CONTACTS: Gerald H. Silk, Mark Lebovitch

This is a shareholder derivative action against the directors of Chesapeake Energy Corporation (“Chesapeake”), brought on behalf of Chesapeake to rescind an amended employment agreement, including a \$75 million bonus award granted to the Company’s co-founder, CEO, and Chairman of the Board, Aubrey Kerr McClendon. The claims include breach of fiduciary duties of due care and loyalty; aiding and abetting; corporate waste; insider selling; and unjust enrichment. In October 2008, the Company announced that McClendon (then, the largest individual shareholder) received three consecutive margin loan calls forcing him to liquidate 94% of his overall position in Chesapeake stock (31.5 million shares, or nearly 6% of the Company, worth over \$640 million). The Company recently admitted in response to an SEC inquiry that the margin calls motivated the Compensation Committee to enter into the amended employment agreement. Moreover, just days prior to the October disclosure, three other directors sold over \$5.2 million in Chesapeake stock, including the sale of 200,000 shares by the Chairman of the Compensation Committee. For the two other insider selling directors, their sales just days before the disclosure were their first ever reported sales of Chesapeake shares.

In addition, the Company recently admitted that, in December 2008, the Board approved – after review and approval by the Audit Committee (of which McClendon’s first cousin is the Chairman) – of the Company “buying” “an extensive collection of historical maps” from McClendon for \$12.1 million.

Six public funds have decided to work together on this litigation as a Plaintiffs’ Steering Committee, and by stipulation and order dated June 9, 2009, the Court appointed Ontario Teachers to serve as the Chair of the Plaintiffs’ Steering Committee. The Court also appointed Bernstein Litowitz Berger & Grossmann LLP to serve as Co-Lead Counsel.

On June 23, 2009, Ontario Teachers and the other members of the Plaintiffs’ Steering Committee filed the Verified Consolidated Shareholder Derivative Petition For Breach Of Fiduciary Duties, Waste, Unjust Enrichment, And Insider Selling.

This case presents important corporate governance issues, including the following:

- The Board’s Compensation Committee proposed the \$75 million bonus after only one day of consideration and without consulting or relying upon any compensation experts;
- McClendon (along with the CFO and COO) is responsible for making recommendations to the Compensation Committee for compensation to executives, including himself;
- The Company’s Compensation Committee Charter requires that the Committee set the CEO’s compensation based on its evaluation of the CEO’s performance in light of corporate goals and objectives, which includes consideration of the Company’s financial performance. The \$75 million bonus and “purchase” of “historical maps” for \$12.1 million puts the interests of McClendon before the interests of the Company and its shareholders.

The Complaint seeks money damages; restitution and disgorgement of profits, benefits and other compensation (by McClendon and the insider trading directors); rescission of McClendon’s new employment agreement, including the \$75 million bonus; corporate governance changes, including requiring the Company to adopt a policy forbidding the Company’s senior officers from using shares of Chesapeake as collateral for margin loans; punitive damages; and attorneys’ fees and expenses.

On August 7, 2009, nominal defendant Chesapeake filed a motion to dismiss the Complaint on the grounds that a demand had not been made on the Board of Directors. On September 8, 2009, Plaintiffs filed an opposition to Chesapeake's motion to dismiss, explaining that a demand on the Board would have been futile.

Defendants' motion to dismiss was granted and Plaintiffs have since filed an appeal of the Court's decision. Subsequently, the case was settled.