

Kallick v. SandRidge Energy, Inc., et al.

COURT: Delaware Court of Chancery
CASE NUMBER: C.A. No. 8182-CS

SandRidge Energy, Inc. (“SandRidge” or the “Company”) is one of the worst-performing energy companies in America, losing approximately 90% of its market capitalization over the last five years. Despite this dreadful performance, the SandRidge board of directors (the “Board”) approved more than \$150 million in compensation for the Company’s CEO and Chairman, Tom Ward (“Ward”), and allowed him to engage in lucrative related-party land transactions at the expense of the Company and its shareholders. By December 2012, SandRidge shareholders had finally had enough and activist hedge fund TPG-Axon started a consent solicitation to replace the entire SandRidge Board.

Knowing that they would be voted out of office in a fair election, the incumbent SandRidge directors threatened shareholders with economic calamity in the event that TPG-Axon’s slate of nominees was elected to the Board. Specifically, SandRidge had issued \$4.3 billion of debt containing “Proxy Puts” - provisions triggering mandatory debt acceleration and redemption if shareholders choose to exercise their voting rights to elect new directors. The incumbents told shareholders that the Company could face insolvency if shareholders elected TPG-Axon’s nominees and triggered the \$4.3 billion debt repayment, an amount larger than the Company’s entire market capitalization and six times greater than the Company’s available cash on hand. Based on the terms of the debt agreements, however, the SandRidge Board possessed the contractual right to “approve” TPG-Axon’s director nominees for the sole purpose of avoiding the risk of debt acceleration. The Board, however, refused to exercise this right. The incumbent SandRidge directors were instead using the threat of repayment to coerce shareholders into supporting the Board’s reelection.

On January 7, 2013, BLB&G initiated a lawsuit in the Delaware Chancery Court challenging the Board’s bad faith refusal to remove the Proxy Puts from the scales of the shareholder franchise.

Following expedited discovery and briefing, on March 8, 2013, Chancellor Leo Strine issued a landmark injunction opinion that paved the way for more faithful fiduciaries to take control of the SandRidge Board. Strine found that the SandRidge Board had breached its fiduciary duties of loyalty and good faith by not exercising its contractual right to approve shareholder-nominated directors in order to disable the Proxy Puts. Strine emphasized that unless the shareholder-sponsored director nominees were criminals or other people of ill-repute whose election would likely put the company at risk, the incumbent directors were required to exercise their power to neutralize the potential debt acceleration. TPG-Axon’s nominees, a group of well-respected current and former public company CEOs, CFOs, oil industry executives and investment management professionals, were far from criminals or known looters.

Strine enjoined the SandRidge Board from: (a) soliciting any further consent solicitations in favor of its director slate; (b) relying upon or otherwise giving effect to any consent solicitations or revocations against TPG-Axon’s slate; and (c) impeding TPG-Axon’s consent solicitation process in any way, unless and until the board approved TPG-Axon’s slate for the limited purpose of the Proxy Puts.

This was a landmark injunction. First, substantive injunctions in the Delaware Chancery Court are extremely rare. Second, this opinion eliminated entrenched boards’ ability to use Proxy Puts to ward off their removal from office.

In a prior case litigated by BLB&G, *San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.*, 983 A.2d 304 (Del. Ch. 2009), the Chancery Court found that a board has the power and the right to approve stockholder nominees to avoid triggering Proxy Puts. However, before the Chancery Court was able to render a decision on whether the failure to exercise this approval right was a breach of the directors' fiduciary duties, the Amylin board agreed to exercise its approval right. The SandRidge opinion was the first court ruling to definitively enforce shareholders' right to an unencumbered vote in this type of context.

On March 12, 2013, the SandRidge Board finally "approved" TPG-Axon's nominees. The next day, the Company agreed to (a) immediately add four of TPG-Axon's director nominees to the SandRidge Board and (b) provide TPG-Axon with majority control of the Board in the event that CEO and Chairman Ward is not terminated by June 30, 2013.