

## Strine's SandRidge Ruling Hands Activist Investors New Tool

By **Liz Hoffman**

*Law360, New York (March 12, 2013, 9:39 PM ET)* -- A ruling last week by Delaware Chancellor Leo Strine will make it harder for companies to head off activist challenges by hiding behind their loan covenants, adding another cudgel to the activist toolkit heading into proxy season, attorneys say.

Chancellor Strine on Friday blocked SandRidge Energy Inc.'s board from interfering with hedge fund TPG-Axon Capital Management LP's attempt to nominate its own slate of directors for the energy company. In doing so, he essentially stripped boards of a defense sometimes used to keep dissident directors at bay.

As the 2013 proxy season heats up, the decision could tip the balance of power toward activist investors pushing for big board shake-ups.

"Judge Strine's decision is an interesting one, one that I think will be very helpful to activists in situations where companies have used threat of debt acceleration to avoid engaging," said Olshan's Steve Wolosky, who represents investors in proxy fights.

Seizing on SandRidge's poor performance and CEO Tom Ward's pay and other perks, TPG-Axon is looking to change the company's bylaws so that board elections would no longer be staggered, and then to replace all of the company's directors.

But SandRidge has refused to approve TPG-Axon's nominees, saying the move would violate a provision in its debt covenants and force it to repurchase some \$4.3 billion in outstanding notes. The provision — often dubbed a "proxy put" or a "poison put" because of its ability to shield boards facing shareholder challenges or hostile buyers — accelerates debt repayment if a majority of board seats turn over to new directors not approved by the incumbent board.

SandRidge, however, could defuse the proxy put simply by approving the new directors as legitimate nominees, according to Chancellor Strine. Finding the board had no basis for withholding its approval, the chancellor enjoined it from soliciting any more anti-TPG votes until it greenlighted the nominees.

"[T]he incumbent board has simply made the same determination that all incumbents who seek to continue in office make: We are better than the new guys and gals, so keep us in office," Strine wrote. "Such self-belief does not come close to a reasoned conclusion that the electoral rivals lack the integrity, character and basic competence to serve in office."

The decision came ahead of a March 15 deadline for shareholders to decide whether to back TPG-Axon's plan.

In his ruling, Chancellor Strine has set a low bar for dissident directors to clear — and a high bar for boards looking to disqualify them. “Known looters” and “persons of suspect integrity” could be denied board approval, as could truly incompetent nominees, he said. But without evidence that TPG’s nominees are any of those things, the board is improperly denying shareholders the chance to vote for change, according to the chancellor.

The ruling follows the 2009 Amylin Pharmaceuticals decision, in which a shareholder challenged the drugmaker's use of a proxy put to fend off a board shake-up from billionaire investor Carl Icahn and investment manager Eastbourne Capital. Vice Chancellor Stephen Lamb went even further than Chancellor Strine did last week, holding that the directors may have breached their fiduciary duty by agreeing to the debt covenant in the first place.

“I think, following on Amylin, boards may find themselves in a tough spot trying to defend these provisions,” Keith Gottfried of Alston & Bird LLP said. “It may make companies rethink how they construct their debt documents.”

The ruling comes as a wave of activism has seized U.S. markets. Icahn is waging three simultaneous fights. Hess Corp. has agreed to sell its retail operations, coinciding with pressure from Elliott Management Corp. First Manhattan Co. is seeking to replace the entire board of drugmaker Vivus Inc. Hedge funder Bill Ackman is three months into what he promises will be a long fight to prove that wholesale vitamin distributor Herbalife Ltd. is a fraud.

“There are so many of these fights out there, more than I've seen in any year I've been doing this,” Wolosky said. “I think the [SandRidge] ruling has the potential to change the landscape.”

The decision's application may be limited, though. For starters, the proxy put defense doesn't come up that often and when it does, a fight for board control is usually well under way. The SandRidge decision may save the parties a stop in chancery court, but likely won't spark a board fight where one didn't already exist, several attorneys said.

And some specifics of the SandRidge case may have shaped Chancellor Strine's ruling. SandRidge first said that triggering the put would “present an extreme, risky and unnecessary financial burden” to the company. But a month later — the day after an order was signed scheduling the injunction hearing — the company reversed course. The put wouldn't be a problem after, it said, because the notes were trading above the offer price and, as a fallback, its own lender was willing to step in and refinance the debt.

Strine noted the board's “thin and shifting arguments” might be a tactical play aimed at keeping control — and he wasn't pleased about it.

“In this context, where the importance of the stockholders' right to choose is paramount, games playing is not something our law takes lightly,” he said.

Gerald Kallick, the investor who filed the class action, is represented by Bernstein Litowitz Berger & Grossmann LLP and Grant & Eisenhofer PA.

SandRidge and its directors are represented by Covington & Burling LLP and Potter Anderson & Corroon LLP.

TPG-Axon, which is not a party to the lawsuit, is being advised in its proxy contest by Schulte Roth & Zabel LLP.

The case is Gerald Kallick v. SandRidge Energy Inc. et al., case No. 8182, in the Court of Chancery of the State of Delaware.

--Editing by Kat Laskowski and Chris Yates.

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