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DELAWARE SUPREME COURT
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IN THE SUPREME COURT OF THE STATE OF DELAWARE

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Wilmington

ALAN R. KAHN,)
 Appellant,)
 Objector-Below,)
 v.)
 JOSEPH SULLIVAN, et al.,)
 Plaintiffs-Below,)
 DR. ARMAND HAMMER, et al.,)
 Defendants-Below,)
 and)
 THE ARMAND HAMMER MUSEUM OF ART)
 AND CULTURAL CENTER, INC.,)
 Intervenor-)
 Defendants-Below,)
 Appellees.)

No. 301, 1990

BARNETT STEPAC,)
 Appellant,)
 Objector-Below,)
 v.)
 JOSEPH SULLIVAN, et al.,)
 Plaintiffs Below,)
 and)
 DR. ARMAND HAMMER, et al.,)
 Defendants Below,)
 and)
 THE ARMAND HAMMER MUSEUM OF ART)
 AND CULTURAL CENTER, INC.,)
 Intervenor-Defendant)
 Below, Appellees.)

No. 312, 1990

CALIFORNIA PUBLIC EMPLOYEES')	
RETIREMENT SYSTEM,)	
)	
Appellant,)	
Objector-Below,)	
v.)	
JOSEPH SULLIVAN, et al.,)	
)	
Plaintiffs-Below,)	No. 313, 1990
)	
DR. ARMAND HAMMER, et al.,)	
)	
Defendants-Below,)	
and)	
)	
THE ARMAND HAMMER MUSEUM OF ART)	
AND CULTURAL CENTER, INC.,)	
)	
Intervenor-)	
Defendants-Below,)	
)	
Appellees.)	

PLAINTIFFS' ANSWERING BRIEF
IN OPPOSITION TO OBJECTORS' APPEAL

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November 21, 1990

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NATURE OF THE PROCEEDINGS AND
THE JUDGMENT SOUGHT TO BE REVIEWED

Three Objectors have appealed from the August 7, 1990 approval of a stockholder derivative and class action settlement by Vice Chancellor Hartnett in Sullivan, et al. v. Dr. Armand Hammer, et al., Del. Ch., C.A. No. 10823 (August 7, 1990).

On July 19, 1989, the Court of Chancery denied Objector Kahn's motion for a preliminary injunction to enjoin settlement negotiations following the signing of a Memorandum of Understanding between the Sullivan plaintiffs and defendants. Kahn v. Occidental Petroleum Corp., Del.Ch., C.A. No. 10808, Hartnett, V.C. (July 19, 1989).* The Court, however, allowed Objectors to take discovery to develop a record. Following this discovery and the signing of the proposed settlement agreement, the parties and the Objectors submitted memoranda and other documents on the issue of whether the proposed settlement should be approved.

On April 4, 1990, after notice of the proposed settlement was disseminated, a hearing was held at which Objectors argued against approval of the proposed settlement. In its Memorandum Opinion of August 7, 1990, the Court found the settlement to be reasonable and granted its approval.

This is the answering brief of plaintiffs on the Objectors' appeal.

* The other objectors supported Kahn's preliminary injunction motion.

SUMMARY OF ARGUMENT

1. There is ample record showing that the lower Court's conclusion that the business judgment rule would probably apply to the defendant directors was not an abuse of discretion. The record showed that the directors had no self-interest in the transaction and that the directors and a Special Committee relied upon detailed expert advice in making their decisions with respect to the Museum project.

2. The Court below did not abuse its discretion in finding that the gift by Occidental Petroleum Corporation to the Armand Hammer Museum of Art was reasonable. There is substantial evidence in the record supporting the reasonableness of the gift (as modified by the settlement) because the size of the gift was not disproportionate to the assets and income of Occidental and because of the tax deductions and goodwill received by Occidental.

3. The Court below did not abuse its discretion in approving the settlement as fair and reasonable. The Vice Chancellor found that Occidental and its stockholders are to receive significant benefits from the settlement, including the good will from naming the Museum building after Occidental and the ability to utilize the adjacent Museum in the promotion of Occidental's business purposes. In addition, as a result of the settlement, Occidental and its stockholders received the right to representation on the Museum Board, a binding contract guaranteeing the art collection would be donated, ceilings on future donations and Museum construction costs, and the right to

consideration should the Museum lease or sell its interest in the Museum property.

4. As required by Delaware Supreme Court Rule 14(b)(iv), plaintiffs state the following with respect to Objectors' Summaries of Argument (Kahn 2, California 2):*

- (1) Denied that the Court below erred in finding that the director defendants probably were entitled to the protection afforded by the business judgment rule.
- (2) Denied that the lower Court abused its discretion in finding that the gift to the Hammer Museum is not within the range of reasonableness.
- (3) Denied that the lower Court abused its discretion by finding the settlement fair and reasonable.**

* References herein to the briefs of the appellant-objectors Alan R. Kahn and California Public Employees' Retirement System shall be "Kahn" and "California", respectively, followed by the page reference. Appellant-objector Barnett Stepak did not file a brief. Citations "A _____" are to pages of the Joint Appendix of Appellants' California Public Employees' Retirement System and Alan R. Kahn to Their Opening Briefs. Citations "B _____" are to pages of their Joint Appendix of Appellees Joseph Sullivan and Alan Brody and the Special Committee of Occidental's Board of Directors.

** Because the Objectors make essentially the same arguments, plaintiffs make a single response thereto.

STATEMENT OF FACTS

Plaintiffs adopt and incorporate by reference the Statement of Facts submitted in the Answering Brief of the Special Committee of Occidental Board of Directors in Opposition to Objectors' Appeal.

A R G U M E N T

THE LOWER COURT DID NOT ABUSE ITS
DISCRETION IN APPROVING THE SETTLEMENT

A. The Standard and Scope of Review

Approval of a class action or derivative settlement is a matter in which a Court of Chancery exercises its independent business judgment. In re Resorts International Shareholders Litigation, Del. Supr., 570 A.2d 259, 266 (1990). In deference to that judgment and the Chancellor's broad discretion, the Supreme Court's scope of review of the Court of Chancery's approval of a settlement is extremely limited. Id. This Court does not apply its own business judgment to the settlement. Id. Rather, it will disturb the lower Court's approval only if the record evidence is so strongly to the contrary that approval of the settlement is a clear abuse of discretion. Id.; Nottingham Partners v. Dana, Del.Supr., 564 A.2d 1089, 1102 (1989); Barkan v. Amsted Industries, Inc., Del. Supr., 567 A.2d 1279, 128 (1989).* This Court considers the record only to determine "if the findings and conclusions of the trial judge are supported by the record and the product of an orderly and logical deductive process . . ." Levitt v. Bouvier, Del. Supr., 287 A.2d 671, 673 (1972); Polk v. Good, Del. Supr., 507 A.2d 531, 536 (1986).

* The Objectors concede that the abuse of discretion standard applies and do not contend that the Vice Chancellor committed any errors of law. Kahn 8; California 18.

Objectors' appeal asserts that the lower Court abused its discretion in balancing the benefits conferred by the settlement as compared to the prospects and range of potential recovery in the litigation. Specifically, the Objectors maintain that the Vice Chancellor abused his discretion (1) in concluding that plaintiffs' potential for ultimate success on the merits was poor by reason of (a) the business judgment rule and (b) the reasonableness of the gift (Kahn 8-33, California 18-28; and (2) in declining to hold that the settlement confers no benefit (Kahn 34, California 29-33). Objectors' arguments fail to cite key record facts which show that the lower Court's findings and conclusions were the "product of an orderly and logical deductive process," Polk v. Good, supra, at 536, that the settlement approved was fair and that the Vice Chancellor did not abuse his wide discretion in approving it.

B. The Court Relied on the Record in
Assessing the Potential for Ultimate Success on the Merits

In reviewing the Vice Chancellor's assessment of the prospects of this litigation, this Court should be mindful of the extraordinary procedural and substantive obstacles plaintiffs faced in this litigation, including:

- (a) Plaintiffs faced a motion to stay discovery and a motion to dismiss, raising the prospect that the action might be dismissed without any discovery.
- (b) Plaintiffs' disclosure claim had been mooted.
- (c) There was a strong possibility that the demand requirement of Chancery Court Rule 23.1 or application of

the business judgment rule would cause dismissal of the action.

(d) Proving breach of duty of care and waste claims related to a charitable contribution would be extremely difficult.

The Vice Chancellor, like counsel for the plaintiffs, is very experienced in assessing such risks in evaluating the likely outcome of litigation. This Court should grant great deference to the Vice Chancellor's independent judgment that these risks made the prospects for success in the litigation very poor.

1. The Record Supports the Court's Conclusion That the Business Judgment Rule Probably Would Apply

The Objectors do not deny that "[t]he business judgment rule 'is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.' Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984)." Sullivan v. Hammer, slip op. at 14. Rather they challenge the factual basis for the Court's conclusion that the business judgment rule probably would apply to the directors' decision to make the charitable gift. Id. at 15. Objectors' argument that the directors made unintelligent or unadvised business decisions in approving the Museum project ignores the detailed record facts which support the Court's findings that the directors were not self-interested and that "the directors and the Special Committee gave due consideration to the transaction." Id. at 15.

(a) The Record Contains Evidence that the Board Was Properly Advised

Objectors conclude that because of a potential conflict of interest involving the Dilworth, Paxson, Kalish & Kauffman law firm (the "Dilworth Firm") the Board received no advice at all. The Special Committee approved the actions taken at its February 1989 meeting at which the Special Committee received advice not only from the Dilworth Firm, but also from the law firm of Skadden, Arps, Slate, Meagher & Flom and from the accounting firm of Arthur Anderson. (B299-312). While the Objectors complain about the independence of the Dilworth firm, they have not and cannot complain about the specific legal advice and factual information which the Special Committee and Board considered in making its deliberations. They merely seek to get as much mileage as possible out of the Vice Chancellor's comments in the July 19, 1989 opinion regarding the desirability of Occidental retaining independent counsel to review the merits of the Board's actions and to advise the Special Committee on the Museum project.

But following the Vice Chancellor's July 19 opinion, the Special Committee met and did adopt the Court's suggestion. (A493(d)). Sullivan v. Hammer, slip op. at 6-7. As a result, on August 4, 1989, the Committee retained former Chancellor Grover C. Brown of the law firm of Morris, James, Hitchens & Williams as its independent counsel. Id. Counsel to the Committee re-examined the basis for the Board's past decisions and negotiated the final settlement with plaintiffs' counsel. Id. at 7. The

Objectors do not and cannot question the independence or advice of Chancellor Brown.

(b) The Record Contains Evidence That Directors' Decisions Were Informed

Under the Objectors' version of the facts, the Museum Proposal was first revealed to the Board on February 16, 1989, a Special Committee was appointed and, two hours later, the Museum Proposal was approved (Kahn 8-9; California 19). This overly simplistic and incorrect recitation is a far cry from the record which the Chancery Court had before it. First, the record demonstrates that Occidental management and the full Board had been considering the funding of the Museum for over a year before approving it and had vested the ultimate decision to approve the funding in a Special Committee of disinterested outside directors (A334). Second, the record reveals that the circumstances surrounding the February 16, 1989 Special Committee meeting and subsequent meetings were far more involved than the Objectors would lead this Court to believe.

The Special Committee gave due consideration to the Museum Proposal. A full report addressing almost every conceivable issue arising from the Museum Proposal was presented to the Special Committee. (A336-337). Those issues included (1) the authority of the corporation to establish and fund the Museum Project, (2) the reasonableness of the proposed donation, (3) a review of the size and nature of the charitable contributions of other corporations, (4) the standard of conduct the directors should follow in considering the proposal, and (5) the financial

and tax consequences to Occidental of such contributions. (A335-336).

On February 6, 1989, a full ten days prior to the scheduled Board meeting, a formal opinion letter and a comprehensive 96-page Memorandum of Law with relevant exhibits was submitted to the Board. (A336-337). On February 10, 1989, Board members received a supplemental tax opinion letter prepared by Skadden, Arps, and a report from the Duncan Appraisal Corporation containing an estimate of a reasonable option price for the Museum's option to purchase the Occidental Petroleum Center building in thirty years. (Id.)

At the Board meeting held on February 16, 1989, a presentation of the report to the Board was made which included a recommendation that the Board appoint a Special Committee of disinterested, outside directors to consider and act on the Museum Proposal. (A337-338); B280-297). At the ensuing meeting of the Special Committee, representatives of the Dilworth Firm, Skadden, Arps and Arthur Anderson all responded to the extensive questioning by the Special Committee members concerning a variety of additional issues. (A340; B299-312). After discussion of the proposal, resulting in a decision to impose certain conditions on their approval not contemplated by the Proposal as originally submitted, did the Special Committee conclude that establishing a new cultural landmark for the City of Los Angeles adjacent to the Occidental headquarters and identifying the Company even more closely with an important art collection and cultural center

would be a substantial benefit to Occidental and its stockholders. (A334-342).

The conditions insisted upon by the Special Committee included (a) proper qualification of the Museum as a non-profit corporation under Delaware law, (b) a determination by the IRS that the Museum is a tax-exempt entity as defined in Section 501(c) of the Internal Revenue Code, (c) supplementation of the February 6, 1989 Dilworth opinion letter to reflect the certain additional tax issues not originally addressed by the Dilworth firm but identified as significant by the Committee members at the meeting of the Special Committee, and (d) the execution of satisfactory documents concerning the (i) Museum's lease, (ii) the option to purchase the Occidental Petroleum Center building, (iii) Occidental's lease-back rights, and (iv) transfer of the art collection to the Museum, all in a form deemed acceptable to the Committee to protect the ongoing interests of the Company. (A341-342).

Because the record reflects that the Board relied upon the detailed expert advice, the Court properly concluded that decisions of the Board and Special Committee were made on an "informed basis" and thus protected by the business judgment rule. 8 Del.C. §141(e); Smith v. Van Gorkom, Del. Supr., 488 A.2d 858, 874-875 (1985). Objectors' attempt to paint a picture of a board of directors acting as a group of "yes men", rubber stamping the whims of Dr. Hammer is an inaccurate characterization of the record relied on by the Vice Chancellor in making his decision.

Objectors' attack on the actions of the Special Committee after the Sullivan and Kahn suits were filed in May of 1989 is a further distortion of the record. At the July 20, 1989 meeting of the Special Committee made a review of documents relating to the conditions established in February for approval of the Museum Proposal. (A493(a)-(d)). Because of the pending litigation and the proposed memorandum of understanding (which ultimately resulted in the settlement), the Special Committee incorporated certain features of the memorandum of understanding into the draft lease and option agreement covering the 30-year lease arrangement between Occidental and the Museum. (A493(c)). The Committee, after deliberation, also authorized Occidental's officers to enter into the lease agreement with the Museum and to provide financial support for the Museum. Id. Finally, the Committee agreed to follow the suggestion of the Court and to seek and retain independent counsel to advise the Committee on the Museum project and the terms of any settlement. (A493(c)-(d)).

The Special Committee's actions reflect a continuation of its efforts to act on an informed basis and in the best interests of the Company. The Committee continued to review the Museum project, sought to settle the pending litigation, and sought to address the concerns raised by the Vice Chancellor. The record supports the Court's conclusion that the business judgment rule could likely be invoked by the defendants and that this defense made the potential for ultimate success on the merits very poor.

2. The Record Supports the Vice Chancellor's Finding That Occidental's Gift is Reasonable

Objectors' attempt to persuade this Court that the sums of money being contributed by Occidental to the museum project, in and of themselves, make Occidental's charitable contribution unreasonable.* Given the net worth of Occidental, its annual net income before taxes, and tax benefits which Occidental will gain in the future, plaintiffs and Objectors certainly would have had great difficulty establishing that the gift to the Hammer Museum (whether or not as modified by the settlement) was unreasonable.

In reaching his conclusion that "[f]rom the present record it is also clear that the present gift (as now limited) is within the range of reasonableness", Sullivan v. Hammer, slip op. at 17, the Vice Chancellor had at his disposal a voluminous record which included a February 3, 1989 tax memorandum which was reviewed by the Special Committee as part of its deliberations. The key points considered by the lower Court in finding that the gift is reasonable are:

1. The only current gift is the annuity which represents about 6.3% of Occidental's net income (B809). Under current tax law, because a corporation is entitled to deduct charitable contributions of up to 10% of the corporation's taxable income, before taking into consideration either the contribution or any net operating loss carryforward, the entire annuity is deductible. (Id.)

* The numbers used by the Objectors are inflated (Compare Kahn, 31 with B794 and B798).

2. The museum building and the parking garage are not being donated at this time; rather, they will be assets owned by Occidental, with the museum building (but not the parking garage) subject to a 30-year lease. The Museum's option to purchase the museum building, a portion of the Occidental headquarters building used by the Museum and the parking garage is exercisable only at the end of the 30-year lease. If the option is exercised then, there may be a gift at that time and a portion of it may be deductible under the then current tax laws. (B807-808).

3. Even if the \$60 million were to be considered a gift, the assets will be owned by Occidental and the construction costs could be amortized over the 30-year term of the option (or \$2 million per year). It makes no sense to claim that the full \$60 million must be accounted for in one year. (B809).

4. While the amount of the gift (\$39 million) and the construction cost (\$60 million) appear large, the size and earnings of Occidental, in comparison, make the charitable contribution reasonable. Occidental had over \$20.5 billion in reported assets as of December 31, 1988 (B139). Its pre-tax earnings in 1988 were \$574 million. (Id.) Given the size of this company and the lack of any evidence that Occidental's dividend policy is endangered or that its business will be stifled in any manner by the charitable gift, the Vice Chancellor's finding of reasonableness is fully supported by the record.

Utilizing this record, the Court found that the gift at issue is within the range of reasonableness under the test set

forth in Theodora Holding Corp. v. Henderson, Del. Ch., 257 A.2d 398 (1969).* Sullivan v. Hammer, slip op. at 17.

There is ample evidence in the record supporting the Vice Chancellor's finding that Occidental's gift is likely within the range of reasonableness under Theodora. First, as demonstrated by the tax memorandum, the entire annuity is deductible under current Internal Revenue Service regulations. Second, the costs of construction, if amortized over the period of the lease, are also deductible. Third, given the size of Occidental, the per share cost to the individual shareholders (estimated at 8 cents per share) (B139-140) is relatively small compared to the overall benefits flowing from the Museum project. The benefits flowing from the Museum project not only benefit the public but also enhance the good will of Occidental. (B141-147; B450).

Objectors criticize the Vice Chancellor for rejecting their view that the Museum is purely a private benefit -- a monument to Dr. Hammer. They also are critical of Dr. Hammer's dispute with the Los Angeles County Museum of Art (LACMA) and the decision to

* Theodora discussed the compelling business rationale for charitable contributions and the provisions of 8 Del.C. §122(9) which reflects "the recognized obligations of corporations towards philanthropic, education and artistic causes" by specifically empowering Delaware corporations to "[m]ake donations for the public welfare or for charitable, scientific or educational purposes". 257 A.2d at 404. The Court looked to two areas to determine whether a particular gift was reasonable. First, the Internal Revenue Code's limitation for deductibility of corporate gifts (which was then 5% of the corporation's total income compared to the present 10%) was deemed a "helpful guide". Second, the cost to the stockholders of the donation was found to be relatively small compared to the overall long term benefits flowing from that donation.

house the art in a facility connected to Occidental headquarters rather than at LACMA. In focusing on these irrelevant matters, the Objectors overlook that Dr. Hammer is personally contributing his art collection, valued at \$400 million (B428), for the benefit of Occidental and the public. The fact that the art collection will be housed at Occidental rather than LACMA does not make Occidental's contribution unreasonable. Further, the Court in Theodora approved as reasonable a charitable donation to a foundation controlled by the majority stockholder of the donor corporation. Even assuming the gift is to a so-called "pet charity", the Court is not required to find the gift unreasonable.

In its assessment of plaintiffs' case here, the Court below reached its conclusions in an orderly and logical manner, relied upon the entire record and properly concluded that plaintiffs would have had a very difficult, if not impossible task, in overcoming the presumption of the business judgment rule and in establishing that Occidental's gift is unreasonable.

C. The Settlement is Fair and Reasonable

The proposed settlement approved by the lower Court provided the following benefits:

1. Public Recognition of Occidental's Contribution.

The museum building is to be named the "Occidental Petroleum Cultural Center Building". Based on the size of contributions that other charities require in order to provide equivalent recognition, Duff & Phelps Financial Consulting Co. ("Duff & Phelps") estimated the value to Occidental of having the building

bear the corporate name to be approximately \$10 million (B414-415).

2. Right to Representation on the Museum's Board of Directors. Occidental is entitled to have at least three of its directors serve on the Museum's Board (or no less than one-third of the total Museum Board) with the option of designating a fourth director.

3. Written Agreement to Donate the Collection. The agreement required Occidental to enter into an agreement with Dr. Hammer requiring an immediate loan of substantially all of the art collections to the museum with an actual transfer of ownership upon the later of Dr. Hammer's death or the commencement of operation of the museum.

4. Limitation on Future Charitable Donations. Future charitable contributions to any Hammer-affiliated charities are limited to 1.33% of the cash dividends paid to Occidental's common stockholders. Moreover, any amounts in excess of \$50 million paid by Occidental for construction of the museum must be charged against this ceiling. Also, Dr. Hammer's employment agreement, which has been publicly known for years, provides for Occidental to make large contributions to Hammer-affiliated charities upon his death. Any such contributions also must be applied toward the ceiling. At current dividend levels, Occidental's annual contributions to Hammer-affiliated charities cannot exceed approximately 3 cents per share.

5. Limitation on Construction Costs. Occidental's expenditures for the museum construction cannot exceed \$50

million, provided that an additional \$10 million could be expended through December 31, 1990, but only if such additional expenditures did not enlarge the scope of construction and were approved by the Special Committee. As a result of this limitation, the project was scaled back by \$19.4 million. (A490).

6. Occidental's Right to 50% of the Sale Proceeds.

Occidental is to receive 50% of any consideration received in excess of the \$55 million option price for the museum property or 50% of any consideration the museum receives from assignment or transfer of its option or lease to a third party.

Objectors, in attacking the Court's finding that the settlement is fair and reasonable, again ignore the record upon which the Court relied. The Duff & Phelps affidavit (B413-417) quantified the benefits achieved through the settlement at between \$30.4 million and \$54.4 million. This did not include benefits which are not subject to quantification. The fact that the Court said the economic value of the benefits is "speculative" does not mean that they are "illusory" as Objectors suggest.

If anything, the lower Court underestimated the significance of the benefits conferred by the settlement. It is uncontested that the settlement resulted in a scaling back of the Museum project which prevented Occidental from spending nearly \$20 million (or even more) in additional funds on construction of the Museum. The Vice Chancellor acknowledged that Occidental would also realize economic value from the naming of the building after

the corporation. The other therapeutic benefits, particularly the future limitations on Occidental's contributions to Hammer related charities, also provide a fair basis for the settlement of plaintiffs' claims.


Plaintiffs in this action sought the best results achievable on the facts and law. Like the Objectors and the Court, the plaintiffs would have preferred that Occidental not contribute so substantially to the Hammer Museum. But as the Court and plaintiffs recognized, the judgment of the Occidental Directors, who were re-elected by the Occidental stockholders shortly after this action was filed, would be very difficult to overturn. Despite the harsh factual and legal realities, plaintiffs achieved a settlement that limited Occidental's commitment to the Museum, capped future gifts to Hammer affiliated charities, and provided tangible benefits to Occidental. Given the record in this case, the Court's approval of the settlement as fair and reasonable cannot be considered a clear abuse of discretion.

CONCLUSION

Objectors' fiery rhetoric and indignation directed at the Museum project were heard twice by the Court below. Objectors were not entitled to a trial on these issues. The Court considered their arguments in the context of the entire record and reached its conclusions in a logical fashion. The decision below should be affirmed.

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