

IN THE SUPREME COURT FOR THE STATE OF DELAWARE

DELAWARE SUPREME COURT  
FILED

CALIFORNIA PUBLIC EMPLOYEES'  
RETIREMENT SYSTEM

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Appellant,  
Objector-Below

DEPUTY CLERK  
Wilmington

No.: 313, 1990

v.

JOSEPH SULLIVAN and ALAN BRODY,  
Plaintiffs-Below

Below: Court of Chancery  
In And For New Castle  
County

DR. ARMAND HAMMER, OCCIDENTAL  
PETROLEUM CORPORATION, DR. RAY  
IRANI, ARTHUR B. KRIM, MORRIE  
A. MOSS, AZIZ D. SYRIANI,  
O.C. DAVIS, SENATOR ALBERT GORE,  
ARTHUR GROMAN, MICHAEL A. HAMMER,  
DAVID A HENTSCHEL, J. ROGER HIRL,  
JOHN KLUGE, LOUIS NIZER,  
GEORGE O. NOLLEY, DR. C. ERWIN  
PIPER, GERALD M. STERN, ROSEMARY  
TOMICH,

Defendants-Below

THE ARMAND HAMMER MUSEUM  
OF ART AND CULTURAL CENTER, INC.

Intervenor,  
Defendants-Below,

Appellees.

OPENING BRIEF OF OBJECTOR-APPELLANT  
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

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DATED: October 18, 1990

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NATURE OF THE PROCEEDING

This is an appeal from a Court of Chancery decision approving settlement of a derivative and class action. This action was one of three shareholder suits pending in the court below, each alleging that the funding by Occidental Petroleum Corporation of the construction and operation of a museum to house the art collection of Occidental's chairman Armand Hammer constitutes a waste of Occidental's assets.

The first action was Kahn v. Occidental Petroleum Corporation, C.A. No. 10808 (the "Kahn action"), filed on May 2, 1989. (A384) This action, Sullivan v. Hammer, C.A. No. 10823 ("the Sullivan action") was filed on May 9, 1989, followed by Stepak v. Hammer, C.A. No. 10860 (the "Stepak action") on June 6, 1989. (Settlement Agreement pp. A-388; A-392) Occidental filed motions to dismiss in the Kahn and Sullivan actions on May 19 and 23, 1989. (A391)

On June 3, 1989, the parties in the Sullivan action entered into a settlement set forth in a Memorandum of Understanding ("MOU"). (A393) On June 9, 1989, Kahn filed a motion to enjoin that settlement; the motion was denied by an opinion dated July 19. (A394)

On September 18, a motion to intervene in the Kahn action was filed by the California Public Employees' Retirement System ("CalPERS"), owner of approximately 2.4 million shares of Occidental. (A396) The motion was granted by order dated February 8, 1990.

On January 24, 1990, counsel for parties in the Sullivan action presented to the Court a fully executed settlement agreement "only slightly changed" from the June 3, 1989, MOU. (Sullivan v. Hammer, Del. Ch., C.A. No. 10823, Hartnett, V.C. (Aug. 7, 1990) pp. 8 and 10) While the Court below found the consideration "speculative" and the benefit to be received by the corporation and its shareholders from the settlement "meager," the Court nevertheless found the benefit sufficient to support the settlement. (Id. at 3, 17, 19.) The Court based its finding on its conclusion that the business judgment rule posed a nearly impenetrable barrier to plaintiff's claims. (Id. at 14.)

#### SUMMARY OF ARGUMENT

1. The Court below erred in finding the director defendants' approval of Occidental's funding of construction and operation of the Hammer Museum was entitled to the presumption of propriety afforded by the business judgment rule. The decision of the Special Committee to commit Occidental to the expenditure of more than \$85 million to build a museum to house the art collection of its chairman was unintelligent and unadvised, rather than informed and deliberate.

2. Occidental's gift to the Hammer Museum is not within the range of reasonableness. Corporate charitable contributions must be tested by a standard of reasonableness as to amount and purpose. By any measure, the amount at issue

is extraordinary, and the purpose is questionable. The Hammer Museum is being built, after Hammer reneged on his long-standing promises to donate his collection to another museum, because Hammer decided he wanted his own museum where he could ensure that all his conditions and demands would be met.

3. The settlement is not fair and reasonable. The speculative or insignificant benefits provided by the settlement are clearly insufficient to justify dismissal of all claims.

#### STATEMENT OF FACTS

##### I. THE CHALLENGED TRANSACTION

Three shareholder suits were filed challenging Occidental's expenditure of more than \$96 million to build and fund the operation of the Armand Hammer Museum of Art and Cultural Center (hereinafter sometimes referred to as "AHMACC" or "Museum"). The directors approved a proposal committing Occidental to the following:

1. Occidental would pay for construction of the Museum building adjacent to Occidental's headquarters, and for a parking garage beneath the Museum, as well as renovation of four floors in Occidental's headquarters building to be used by the Museum. The cost of such construction and renovation was estimated at \$50 million. Occidental would also purchase an annuity to fund the Museum, at a cost of approximately \$36 million. (A242-243)

2. Occidental would lease the Museum Complex (the Museum Building and first four floors of the headquarters building) to the Museum for 30 years, rent free. (A242-243)

3. Occidental would grant the Museum an irrevocable option to purchase the Museum Complex and Occidental's headquarters building in 30 years for \$55 million. (A243-244)

Approval of Occidental's funding of the Museum project as described above was conditioned, among other things, upon execution of appropriate documents relating to transfer of the art collection to the Museum. (A237-238) The collection included paintings, sometimes referred to as the "Five Centuries of Art"; a collection of prints and other works by Daumier; and a manuscript or notebook by Leonardo da Vinci, known as Codex Hammer. (A413e) Some of the collection had been paid for by the Armand Hammer Foundation, which had spent approximately \$10 million for that purpose. In addition, Occidental paid approximately \$6 million for purchase of the Leonardo da Vinci notebooks. (A278)

## II. TERMS OF THE SETTLEMENT

The settlement entered into by the Sullivan parties and approved by the Court below provides as follows:

1. Occidental's name will be on the Museum building, and Occidental will be treated as a corporate sponsor. (A401-402)

2. Occidental shall have the right to minority representation on the Museum's Board of Directors. (A402)

3. The settlement agreement recites that a written agreement to donate the art collection to the Museum has been executed. (A403)

4. All future charitable contributions by Occidental to Hammer-affiliated charities, excluding the construction and start-up cost and property taxes for the Museum, shall be limited to 1.33 percent of the cash dividends paid to Occidental's common stockholders in the prior year. (A404-405)

5. Occidental's expenditures for Museum construction costs may not exceed \$60 million. Any expenditures made in excess of \$50 million shall be a charge against the limitation on contributions to Hammer-affiliated charities, described above. (A406-406a)

6. If the Museum exercises its option to purchase the Museum, parking garage and headquarters building and then sells or otherwise disposes of all or part of the property, Occidental shall be entitled to 50 percent of any consideration received in excess of the \$55 million option price. (A406a)

### III. THE MUSEUM PROJECT

Prior to proposing construction of his own Museum, Dr. Hammer had, over a period of approximately 20 years, represented orally and in writing that it was his intention to donate the art collection to the Los Angeles County Museum of Art (hereinafter "LACMA"). (A281, A147) Hammer made

numerous representations, oral and written, to LACMA or its associates regarding his intentions to donate his collection to that museum. (A294-295) Hammer made a codicil in 1971, effecting such donation, and had a copy sent to LACMA's attorneys. (A324-328) He published this intent in one of his autobiographies. (A323)

At the time Occidental agreed to pay \$6 million to purchase the Leonardo notebooks for Hammer, he represented to Occidental's Executive Committee that the notebooks would be donated to LACMA. (A278) Hammer also specifically represented the Daumier collection would be donated to LACMA. Prior to Hammer's purchase of the Daumier collection, it had been offered to LACMA, which had agreed to buy it. Dr. Hammer, at the time a trustee of LACMA, indicated he wished to acquire the collection himself. Hammer told both the seller of the collection and LACMA that he would commit to donating the Daumier collection to LACMA, although he did not enter into a binding agreement to do so. (A87-90, A289)

Based on Hammer's representations, LACMA had constructed exhibit space, re-figured galleries, and made construction decisions. (A464, A170) Even worse, however, LACMA had for a period of years made decisions concerning acquisitions on the basis of Hammer's promises. (A282-288)

Occidental had made gifts to LACMA in contemplation of Hammer's donating his collection to that museum. In addition to the Occidental funding of the purchase of the

Leonardo notebooks, in 1980 Occidental gave \$2 million to LACMA for expansion and improvement of that museum's Hammer Wing. (A139)

Notwithstanding these prior representations and LACMA's reliance thereon, Hammer elected not to make such donation but to build his own museum instead. That decision was made after LACMA rejected certain demands made by Hammer. In July, 1987, Hammer presented a written list of demands to LACMA, including the following:

1. The collection would be exhibited only in the Hammer Building and no other works of art could be exhibited there. (A142)

2. LACMA would be required to remove from the Hammer Building all plaques or displays memorializing the gifts of other donors. (A141)

3. There would be a separate curator for the Hammer collection, to be appointed and discharged solely in the discretion of the Hammer Foundation. (A144-146)

4. None of the works in the collection could be sold by LACMA under any circumstances. (A142-143)

5. Art already donated to LACMA by Hammer would now be governed by these new conditions. (A143)

LACMA responded by a letter dated October 2, 1987, that it could accept some of the many provisions set forth in the lengthy document Hammer had provided, but that it was unable to accept others. LACMA's letter indicated the Museum

was unable to agree to any restrictions with respect to previously donated art, since such art had been donated outright some years earlier. LACMA also objected to appointment of a Hammer curator acting independently of LACMA's board, suggesting that such an arrangement would result in administrative chaos. Finally, LACMA was unable to agree to removal of the names of other donors which had been put up in recognition of gifts of \$250,000 to \$500,000. (A148-149)

Hammer responded angrily to LACMA's October, 1987, letter, terming it an "ultimatum". (A93-94) He determined that he "wasn't going to be pushed around." (A93-94, A124)

Even though virtually all the conditions at issue ultimately were agreed to by LACMA or conceded by Hammer (A299b, A304, A275), Hammer nevertheless determined to have his own museum and proceeded with plans to have Occidental build it. At a January 19, 1988, meeting of Occidental's Executive Committee, he proposed that Occidental, in conjunction with the Hammer Foundation, construct such a Museum. (A164) Hammer announced at that meeting that he had interviewed architects and selected one, presented a model of the proposed museum, and stated a public announcement of the project had been planned for January 21. (A165) At that time, the Museum building was estimated to cost \$30 million to complete. (A165) The Executive Committee that day approved Occidental proceeding with negotiation of arrangements for the

design and construction of a museum. (A166) On February 11, 1988, the full Board approved the Executive Committee's action. (A335)

The museum project was publicly announced January 21, 1988. (A170, A173-174) Negative reaction in the Los Angeles area press followed, with some art critics questioning whether the quality and content of the collection warranted a separate museum, or whether the public might not gain a greater benefit from the integration of the collection into a large museum such as LACMA. (A260-265, A173-178)

Work on the Museum to be funded by Occidental proceeded, and \$5 million had already been spent before the proposal received consideration by a Special Committee in February, 1989. (A248) On December 15, 1988, at a regular meeting of the Board of Directors, Dr. Hammer presented a plan for "financial support" by Occidental for the Hammer Museum. (A348-353) The Board approved preparation of a study of the Museum proposal. (A335)

Prior to the February 16, 1989, regular meeting of the Board of the Directors, an opinion letter and related memorandum, dated February 6, 1989, and prepared by the law firm of Dilworth, Paxson, Kalish & Kauffman, was sent to all members of the Board. (A220, 223) The meeting was called to order at 9:00 a.m. After some other business, a member of the law firm of Dilworth, Paxson made a presentation of the firm's opinion of a proposal for Occidental's support of the Hammer

Museum. (A220-221) A Special Committee of members of the Board who were not associated with the Museum or the Hammer Foundation, and were not officers of Occidental, was appointed. Defendants Gore, Kluge, Krim, Nizer, Nolley, Piper, Syriani, & Tomich were appointed to the Special Committee. (A223-225)

At approximately 10:15 a.m., the Board meeting was adjourned to allow the Special Committee to meet. (A225) When the Special Committee meeting adjourned 2 hours later, the following proposal had been approved: (A237-239)

1. Occidental would construct and pay for a new Museum and a parking garage beneath the Museum. The 76,000 square foot Museum, built to house Hammer's collection, including the Codex Hammer, the "Five Centuries of Art" and the Daumier Collection, would include a library, auditorium and restaurant, as well as exhibition space. Occidental would also pay to renovate four floors of its headquarters building for use by the Museum. The aggregate cost of construction and renovation was to be approximately \$50 million. (A242)

2. Occidental would pay for an annuity to provide funding for the Museum's operations. The estimated cost of the annuity was \$35.6 million. (A243)

3. Occidental would lease the entire Museum Complex (the Museum building and renovated four floors of the headquarters building) to the Museum for 30 years, rent free. Occidental would be responsible for payment of all property

taxes. (A242-243)

4. Occidental would grant the Museum an irrevocable option to purchase the Museum Complex and Occidental's headquarters building at the end of 30 years for \$55 million. (A243)

5. Dr. Hammer and his Foundation would transfer the entire collection of art to the Museum. (A241)

6. The museum would be named for Dr. Hammer. (A245)

7. Occidental would receive public acknowledgement of its role, for example, by naming the courtyard, auditorium or library, and would be entitled to corporate sponsor rights available to other corporate contributors. (A244)

8. The Museum's nine-member Board of Directors would include Dr. Hammer and three others associated with Occidental. (A245)

The Special Committee approved the proposal, subject to the following conditions: (1) incorporation of the Museum as a non-profit Delaware corporation; (2) a determination by the Internal Revenue Service that the Museum is tax-exempt; (3) receipt by Occidental of opinion letters that the proposal will not result in any determination of self-dealing; and (4) execution of appropriate documents relating to the lease of the Museum Complex, the Museum's option to purchase the Complex, and transfer of the art collection from the Hammer Foundation and Dr. Hammer to the Museum. (A237-238)

Those present at the Special Committee meeting

included Occidental's accountants, a law firm representing the proposed Museum, and members of the law firm of Dilworth, Paxson, Kalish & Kauffman, as counsel to the Committee. (A228-229) That firm had been selected by Hammer, and the firm was at that time representing Dr. Hammer personally. (A105a, A113) These facts were unknown to the Special Committee, who made no inquiry into the independence of the counsel advising them. (A179-181)

Approval of expenditure of approximately \$86.5 million to build and fund the Hammer Museum was approved by the Special Committee without benefit of independent legal or accounting advice, and without an independent appraisal of the appropriateness of the \$55 million option purchase price. (A105a, A113, A115, A180) The extraordinary size of Occidental's gift<sup>1/</sup> was justified in the memorandum prepared by the Dilworth, Paxson firm by comparing the Occidental gift to contributions of other corporations. (A249-254) The figure used for comparison of the Occidental contribution, however, was \$33.5 million, the estimated cost of the annuity alone. (A251) The memorandum did not take into account the estimated \$50 million for construction and renovation, and also omitted any discussion of the extent to which the contributions of other corporations cited for comparison

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1. The originally approved figure of approximately \$86 million represents a significant portion of Occidental's net income. Net income for 1988 was \$302 million and, for 1989, \$285 million.

purposes were a large single gift for a charitable purpose proposed by and closely affiliated with the corporation's chairman. (A249-253)

According to its Chairman, the Special Committee was unaware both of Hammer's repeated statements of his intent to donate the art collection to LACMA and of unfavorable public reaction to Hammer's reneging on those promises. (A199-203, A205) The Special Committee was unaware of and made no inquiry into any damage done LACMA by reliance on Hammer's promises. (A204) The Special Committee was also uninformed and made no inquiry as to the need for an additional museum in the Los Angeles area. (A210)

The full meeting of the Board reconvened at approximately 12:20 p.m. The Chairman of the Special Committee made a report to the Board, and the proposal was then approved, subject to the conditions described above. (A225-227)

Work on the Museum project continued. The annuity was purchased at a cost of \$36 million; the first set of complete plans from the architects was issued in May, 1989; and the work had progressed sufficiently that the general contractor's budget had been prepared by the following month. (A391, A488-489)

On August 4, 1989, almost six months after approving Occidental's funding of the Museum project, the Special Committee retained independent counsel to review the merits

of the shareholder lawsuits and to advise the Committee with regard to Occidental's funding of the Museum. (A500-501) On October 6, authority was delegated to the Special Committee to approve or disapprove the proposed settlement in this matter. (A397)

IV. THE SHAREHOLDER ACTIONS

On May 2, 1989, the Kahn action was filed. Subsequently, on May 9, 1989, the Sullivan action was filed, followed several weeks later by the Stepak action. (A387-388, A392) All the lawsuits alleged that Occidental's expenditures and commitments with regard to the funding of the Museum constituted a waste of Occidental's assets and that the director defendants had breached their duty to the corporation and its shareholders.

In late May, 1989, a motion was made and unanimously passed by Occidental's Board of Directors to give Hammer authority to settle the pending lawsuits in Delaware. (A216-217) The Chairman of the Special Committee characterized this authorization as having given Hammer "carte blanche" to negotiate a settlement. (A218)

On June 3, 1989, several weeks after filing of the Sullivan action, without the benefit of any discovery proceedings, the parties to the Sullivan action signed a Memorandum of Understanding ("MOU"). (A393) The MOU contained the following provisions:

1. The Museum would be named the Hammer Museum; the

building would be named after Occidental. (A37)

2. Occidental would have a right to designate a minority of the Museum's Board of Directors. (A37)

3. There would be a legally enforceable written agreement from the Hammer Foundation and from Dr. Hammer to donate the art collections. (A37-38)

4. Donations to Hammer-affiliated charities would be limited to 1.33 percent of cash dividends paid to common shareholders in the prior year. (A38-39)

5. Dr. Hammer's current compensation agreement would remain in effect; however, the required payment upon his death to the Hammer Foundation would be charged in seven equal installments against the 1.33 percent limitation referred to above. (A39)

6. Occidental would pay for construction and renovation costs of the Museum, as well as construction of a parking facility. Expenditures for this purpose by Occidental would be limited to \$50 million; however, an additional \$10 million could be spent. (A39-40)

7. In the event the Museum exercised its 30-year purchase option and subsequently sold or otherwise disposed of the property, Occidental would receive 50 percent of any consideration in excess of the \$55 million option purchase price. (A40-41)

8. Attorneys' fees of \$1.4 million would be requested, to be paid by Occidental, and not objected to by

defendants. (A41)

On approximately June 9, 1989, the plaintiff in the Kahn action filed a motion for preliminary injunction to enjoin the settlement. After briefing, the motion was denied by opinion dated July 19, 1989. (A394) The court found plaintiff Kahn would suffer no irreparable harm if a proposed settlement were finalized and then submitted to the Court for approval since, at that time, the court would schedule a hearing on the settlement. (Kahn v. Occidental Petroleum Corporation, Del. Ch., C.A. No. 10808, Hartnett, V.C. (July 19, 1989) p. 11.) The court nevertheless noted the proposed settlement was subject to criticism and cited a number of troublesome issues, including the following: The failure of the Special Committee to hire its own counsel and advisors; the "now worthlessness" of a prior donation by Occidental to LACMA; the "egocentric nature" of some of Hammer's objections to LACMA receiving his donation; and the lack of "any direct substantial benefit" to the shareholders. (Id. at 13). This MOU, changed only slightly, became the settlement approved by the Court below. (Sullivan v. Hammer, Del. Ch., C.A. No. 10823, Hartnett, B.C. (August 7, 1990) p. 10.)

A document dated July 21, 1989, was executed, providing for lease to the Museum of the Museum Building and the four renovated floors of Occidental's building. (A413a-413b) This agreement provided, among other things, that the

sole name on the "premises" (defined to include the Museum Building and four floors of Occidental's building) would, in perpetuity, be the Armand Hammer Museum of Art and Cultural Center; no part of the Museum could be designated by any other name. (A-413(b); A-413(d)) The lease further provided that no part of the Museum, including gallery and exhibition space, could at any time bear any other name then that of Armand Hammer, the Armand Hammer Foundation or the Armand Hammer Museum of Art and Cultural Center. (A-413(d)) It also provided that the Codex by Leonardo da Vinci should be known solely by the name of "Codex Hammer" in perpetuity. (A-413(c))

On January 24, 1990, counsel for parties in the Sullivan action presented to the Court a fully executed settlement agreement "only slightly changed" from the June 3, 1989, MOU. (Sullivan v. Hammer, supra, at 8 and 10.) Notice was sent to all class members, and a settlement hearing was held on April 4, 1990. A number of shareholders appeared at the hearing, through counsel or in person, or wrote letters objecting to the settlement. (Id. at 8-9.)

By an opinion dated August 7, 1990, the Court approved the settlement as fair and reasonable. Although the Court viewed the consideration received by the class as "speculative" and "meager," the Court concluded, in the exercise of its business judgment, that the consideration was adequate to support the settlement. (Id. at 3 and 17) The Court based this conclusion on its finding that the potential

for ultimate success was "very poor." (Id. at 14) The Court found the directors and the Special Committee had given due consideration to the challenged transaction, and that the gift was within the range of reasonableness. (Id. at 15 and 17)

#### ARGUMENT

### I. THE COURT BELOW ERRED IN FINDING DEFENDANTS' ACTIONS ENTITLED TO THE PROTECTION OF THE BUSINESS JUDGMENT RULE

#### A. Standard And Scope Of Review

The standard of review is that set forth in Levitt v. Bouvier, Del. Supr., 287 A.2d 671 (1972). The lower Court's determination of the issues argued herein is not "supported by the record" and is not "the product of an orderly and logical deductive process." Id. at 673. The evidence is so strongly to the contrary of the Court's findings and conclusions as to amount to an abuse of discretion. Polk v. Good, Del. Supr., 507 A.2d 531, 536 (1986).

#### B. Merits Of The Argument

##### 1. The Business Judgment Rule Requires An Informed, Deliberate Decision

The business judgment rule affords 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 taken was in the best interests of the company." Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984). The rule, however, provides no protection for an "unintelligent or unadvised judgment." Smith v. Van Gorkom, Del. Supr., 488 A.2d 858, 872 (1985).

Directors have an affirmative duty to protect the financial interest of others, and must proceed with "a critical eye" in assessing the information available to them. Id. at 872. It is against this standard of the directors' obligation to make an informed, deliberate decision that their conduct must be tested. Id. at 873.

2. The Court Erred In Finding Defendants Gave Due Consideration To The Challenged Transaction

The Court below found the record showed the defendant directors gave due consideration to the Museum transaction. Sullivan v. Hammer, Del. Ch., C.A. No. 10823, Hartnett, V.C. (Aug. 7, 1990) p. 15. The evidence, however, is so strongly to the contrary as to amount to an abuse of discretion. In fact, the record compels the conclusion the Special Committee and other directors were grossly negligent in failing to inform themselves of all material information reasonably available to them. See Smith v. Van Gorkom, 488 A.2d at 872.

a. The Special Committee's February, 1989, Approval Of The Museum Project Was Unadvised And Uninformed

The Special Committee decided on February 16, 1989, after a two-hour meeting, to approve funding by Occidental of the construction and operating costs of the Hammer Museum. The Committee was advised by, and relied on a memorandum prepared by, a law firm which had been selected by Hammer, the person most closely concerned with the outcome of the Special

Committee's deliberations. In addition, the law firm was at that time representing Hammer personally. The Special Committee approved an extraordinary gift of approximately \$86 million by Occidental, without benefit of independent legal, accounting, or appraisal advice. (See Statement of Facts, p. 11.)

Occidental's directors and their advisors attempted to justify this extraordinary gift by reference to the substantial good will it would generate for Occidental. In fact, it is not clear that such good will has been or will be generated; rather, Hammer's building of his own Museum funded by Occidental, has generated controversy and ill will in the community where the corporation's headquarters are located. (See Statement of Facts, pp. 8 and 12)

The Special Committee, however, was unaware of such ill will and made no inquiry into the circumstances surrounding Hammer's reneging on his promises to LACMA and his determination to build his own Museum. The Special Committee was unaware of, and apparently made no inquiry into, the implications of Hammer's repeated promises to donate his collection to LACMA, the damage done to LACMA by reliance on those promises, and the need for or desirability of another museum in the Los Angeles area. (See Statement of Facts, pp. 12-13.)

Furthermore, it was not at all clear that whatever good will might be generated by the Hammer Museum would

necessarily inure to Occidental's benefit. Minimal provision was made to ensure that Occidental's association with and contribution to the Museum would be recognized. The Museum and everything in it were to be named for Hammer, while Occidental was to receive its recognition by, for example, "naming the courtyard, auditorium or library." (A244)

The testimony of the Chairman of the Special Committee shows the Committee was unaware of other material aspects of the transaction as well. For example, the Special Committee was apparently uninformed as to potential tax consequences, the value of the art, how much of the art had been purchased with donations from Occidental, and what the cost would be to Occidental for the Museum's rent-free use of the property. (A182, A184-186, A188, A195-198, A211-212, A215)

The Special Committee's approval of the Museum project on February 16, 1989, did not follow a lengthy period of consideration and inquiry. Although Occidental's Executive Committee, and later the full Board, discussed a Museum project in January, 1988, the presentation made by Hammer at that meeting was extremely sketchy and only very minimal information was available or provided at that time. (A164-169) All that was approved at that time was the beginning of negotiation of arrangements for design and construction of a Museum. (A166) Although the Museum project was publicly announced January 21, 1988, just two days after the Executive Committee meeting, the project, and Occidental's funding of

it, apparently was not discussed or considered in any detail until late that year. (See Statement of Facts, pp. 8-9)

It should be noted that at the time of the initial consideration of Occidental funding a museum, Hammer had already taken steps to realize his ambition. Prior to seeking the Executive Committee's blessing at the January 19, 1988, meeting, Hammer had already interviewed and selected an architect, had a model constructed, and planned the public announcement of the Museum for just two days later. (A165) The press release planned for that announcement already stated that "Occidental intends to build" a museum, before the full Board had considered the project. (A356) Later, by the time the Special Committee first considered the Museum project in February, 1989, \$5 million had already been spent.

b. Defendants' Failure To Make An Informed, Advised Decision Was Not Cured By Subsequent Conduct

It is not clear that directors can, in all instances, cure an uninformed, unadvised decision. See Smith v. Van Gorkom, 488 A.2d at 885-886. In any event, it cannot be concluded that the Special Committee's original uninformed decision, made without benefit of independent legal or accounting advice, was cured by the hiring, six months later, of independent counsel. At that point, in August, 1989, there was absolutely no downside to the Special Committee reaffirming its earlier decision. By then, the MOU had been negotiated, representing a settlement which would dismiss all

claims arising from the Committee's approval of the Museum transaction, in return for nothing more than proceeding with the Museum as originally planned.<sup>2/</sup>

Furthermore, even after independent counsel was retained, the Special Committee did not act, with regard to Occidental's funding of the Museum project, with any more effectiveness in providing that necessary "critical eye." See Smith v. Van Gorkom, 488 A.2d at 872. By June, 1989, it had become clear that the Museum costs had increased considerably, to a total of approximately \$78 million. (A490) Under the terms of the negotiated settlement, expenditures in excess of the original estimate of \$50 million required approval by Occidental's Board of Directors. (A40) Despite the fact that Occidental had been aware since approximately mid-1989 that the cost to complete the Museum construction would exceed \$50 million, approval by the Special Committee, and subsequently the full Board, was not sought or obtained until March, 1990.

II. OCCIDENTAL'S GIFT TO THE HAMMER MUSEUM IS NOT WITHIN THE RANGE OF REASONABLENESS

A. Standard and Scope of Review

The standard and scope of review is as set forth in Section I.A. above.

B. Merits of the Argument

The Court below concluded it was "reasonably

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2. The settlement provisions, except for the payment of attorneys' fees, imposed requirements that were either part of the original Museum project, or were, at best, illusory limitations on Occidental. See Section III below.

probable" that plaintiffs would fail to prevail on their claim that Occidental's gift to the Hammer Museum constitutes waste. The Court found instead that the gift at issue is within the range of reasonableness. Sullivan v. Hammer, supra, at 17. The present record is necessarily limited, and it is not the responsibility of the Court below, in considering whether to approve a settlement, to try the issues presented. Polk v. Good, 507 A.2d at 536. Even on the limited record available here, however, there is ample evidence that the gift in question is not reasonable, either in size or purpose.

Charitable contributions by corporations are widely accepted and authorized by virtually all states' laws. Such gifts must, however, be reasonable in amount and purpose. A.P. Smith Manufacturing Co. v. Barlow, 13 N.J. 145, 98 A.2d 581, appeal dismissed, 346 U.S. 861 (1953). This is not to say gifts beyond some specific amount are impermissible, but the standard to be applied is one of reasonableness. Theodora Holding Corp. v. Henderson, Del Ch., 257 A.2d 398, 405 (1969). Charitable contributions should not be "made indiscriminately or to a pet charity of the corporate directors in furtherance of personal rather than corporate ends". A. P. Smith Mfg. Co. v. Barlow, 257 A.2d at 590.

In an analysis of the principles governing corporate giving, David S. Ruder suggests charitable contributions must be justified by reference to the goal of profit maximization. Ruder, Public Obligations of Private Corporations, 114 U. Pa.

L. Rev. 209, 215 and 227 (1965). This is not to say there must be a direct relationship between charitable contributions and profit; the author maintains, however, that profit maximization must remain as the "guiding principle" and notes that rejection of this goal and "substitution of the public interest carries significant and extensive legal consequences." Id. at 213, 227.

Occidental's undertaking to build and fund its chairman's Museum represents a gift that is extraordinary in amount and questionable in purpose. An examination of all the circumstances compels the conclusion that the gift was made indiscriminately, in furtherance of Hammer's personal goals, and that it cannot be justified by reference to any legitimate corporate purpose or proportionate benefit to the corporation. The size of this charitable contribution was enormous when approved -- an estimated cost to Occidental of \$86 million for construction of the Museum and purchase of the annuity. This figure, however, actually understates the cost to Occidental. Additional costs, although clearly attributable to the Museum project, have not been allocated to it.

For example, in material presented to the Special Committee prior to its February 16, 1989, meeting, the estimated cost of the project included \$7 million as the Museum's proportionate share of the \$55 million purchase price paid by Occidental for its headquarters building, allocable

to the space to be leased rent-free to the Museum. (A255-256) That \$7 million is no longer included in the cost of the Museum project. In addition, none of the costs associated with or attributable to the 30-year rent-free lease have been included in the Museum costs, nor have any of the costs associated with the Museum's irrevocable option to purchase the Museum, parking garage and headquarters building in 30 years for \$55 million (an amount less than the current construction and renovation cost for the Museum and garage alone) been included.

Occidental has also failed to include certain out-of-pocket costs borne by the corporation in the Museum budget, although such costs are directly attributable to the Museum. These costs include salaries of Occidental personnel who have devoted substantial time to the Museum project (A474-476); payments made to persuade outside tenants to vacate early (one tenant alone was paid \$300,000) (A477-478); asbestos removal costs of approximately \$700,000 for the four floors to be occupied by the Museum (A479); and parking costs for Occidental employees displaced by demolition of the previously existing garage. (A483-485)

When the \$60 million in construction costs already approved and the \$36 million in cost of the annuity are added to the other costs not allocated to the Museum project by Occidental, it is apparent that the cost of this gift to the corporation will be well in excess of \$100 million. Even if

the amount of the contribution is set at \$95 million (the current estimated cost of construction of \$59 million plus \$36 million for the annuity), that figure represents 31 percent of Occidental's net income before taxes for 1988. If the \$95 million is divided into the annuity and the construction cost, and those costs are allocated to 1988 and 1989, respectively, those costs represent 12 percent and 21 percent of net income for those respective years.

The high cost of this contribution seems even more extraordinary and irresponsible in light of Occidental's financial condition. The corporation is committed to payment of high dividends; the dividend level has been unusually high since 1974, even though net income has not covered the dividend since 1984. (A468) The corporation has no intention of changing its high dividend policy, which is necessary to support and stabilize its share price. (A468, 415) The company also underwent a restructuring last year, cutting nine hundred jobs. (A469) A contribution of this size to a pet charity, from a corporation with high debt and high dividends, is not reasonable.

That the gift at issue is no ordinary charitable contribution is clear. The Hammer Museum is not being built because it is needed in the community or is necessary to house Hammer's art. The Museum is being built because, in a fit of pique, Hammer reneged on long-standing promises to LACMA to donate his collection there, and decided he wanted his own

Museum where he could insure that his conditions and demands would be met.

As set forth in the Statement of Facts, Hammer's decision to build his own Museum, funded by Occidental, followed the failure of LACMA to immediately agree to demands set forth in a lengthy document Hammer gave LACMA in July, 1987. Although some of those demands were impossible for LACMA to comply with, it should be noted that virtually all the conditions were eventually conceded or agreed to. (A299b, A304, A275)

Although a gift to a museum is ordinarily for a legitimate charitable and corporate purpose, that is not the case here. The Special Committee made a decision, approved by the full Board, to commit a publicly-held corporation to fully fund the building of an expensive structure to house its chairman's art collection, after that chairman reneged on years of promises to donate the collection to another museum. The Museum proposal approved and carried out requires the Museum to be named after Hammer and to bear no name but his, and it will be controlled by him.<sup>3/</sup> The Special Committee also used corporate money to fund the Museum's operating expenses through purchase of an annuity and through granting of a 30-year rent-free lease and an option to purchase the Museum, parking garage and Occidental's

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3. Insofar as the Museum is run by the Hammer Foundation, the Foundation is a charitable corporation controlled by Hammer as trustee.

headquarters building on extremely favorable terms.

III. THE SETTLEMENT IS NOT FAIR AND REASONABLE  
IN LIGHT OF THE MEAGER CONSIDERATION AND  
PROBABLE VALIDITY OF THE CLAIMS

A. Standard and Scope of Review

The standard and scope of review is the same as that set forth in I.A. above.

B. Merits of the Argument

1. The Benefits of the Settlement Are  
Minimal or Speculative, At Best

The Court below found the consideration provided by the settlement to be "speculative" and the benefit to the class "meager" and "barely adequate." Sullivan v. Hammer, supra, pp. 3, 17, and 19. This characterization is clearly justified by an examination of the purported benefits of the settlement.

Many of the provisions of the settlement were, in fact, part of the original Museum proposal as approved by the Special Committee on February 16, 1989. The following settlement provisions are part of that original approved proposal: public acknowledgment and corporate sponsorship rights for Occidental (A244); transfer of the art collection to the Museum (A241, A237-238); and minority representation for Occidental on the Museum Board of Directors (A245)

The originally approved Museum proposal allowed for construction costs of \$50 million. The settlement's so-called "limitation" on costs in fact allows Occidental to spend an additional \$10 million over the original commitment. T h e

limit on charitable contributions is also illusory. This provision limits donations by Occidental to Hammer-affiliated charities in any one year to 1.33 percent of the cash dividends to common stockholders in the prior year. The costs for the Museum are, however, excluded from this limitation. Furthermore, the settlement provides that to the extent the limit is not reached in any one year, the allowable amount may be accumulated and carried over to subsequent years. The result of these provisions, and of Occidental's long standing policy of high dividends levels, is that the "limit" imposed by the settlement would not have come into play in any year, going back as far as 1982. The limitation on contributions for those years, based on the figure of 1.33 percent of dividends, would have ranged from a low of \$4 million to a high of \$9 million, with an average of approximately \$7 million. The limitation imposed by the settlement on these contributions will, based on prior experience, therefore have no effect whatsoever.

The settlement also provides that if the Museum exercises its option to purchase the Museum Complex and Occidental headquarters and then sells or otherwise disposes of the property, Occidental will receive one half of any consideration in excess of the \$55 million option purchase price. Any benefit attributable to this provision is highly speculative. Further, given the extremely favorable terms to the Museum of its option to purchase, and the questionable

validity of the \$55 million purchase price, this settlement provision cannot be considered significant.

2. The Benefit To Be Received  
Is Insufficient to Justify  
Dismissal of All Claims

The settlement cannot be justified on its face; it provides only minimal benefit to the corporation or its shareholders. Other benefits, however, not apparent from the terms of the settlement, have been suggested in its support.

The first of these is the purported good will which will accrue to Occidental as a result of its funding the Museum. This, however, is also an illusory benefit at best. As discussed elsewhere, it is questionable whether the Museum will garner any significant good will, whether what good will there is will accrue to Occidental rather than to Hammer, and whether any such good will is adequate to compensate for the extraordinary gift at issue here.

Given that the Museum is so closely associated with Hammer, whose name is the only one that can appear in or on the Museum, it seems highly unlikely that Occidental will gain good will sufficient to justify this large contribution to a pet charity. Occidental's lack of identification with the Museum is typified by a Museum brochure. That brochure states Hammer "will contribute a distinguished" cultural landmark to the area. (A362) Although Hammer's name appears repeatedly, the sole mention of Occidental occurs when the Museum is described as being built on property "currently occupied by"

Occidental's headquarters. (A362)

It has also been suggested that a benefit of the settlement is preservation of the art collection for the benefit of the public. There is absolutely no support in the record for the proposition that were it not for this settlement, the art collection would not be available to the public in this county, or would somehow be broken up, sold, or otherwise not preserved. In fact, it is absolutely clear that preservation and public display of the art collection as a whole is a primary motivation in Hammer's having Occidental build his Museum. Hammer has gone to great lengths to be certain the collection will not be broken up, but will be kept together in perpetuity, with his name and his name only on the collection and the Museum in which is it housed.

There is substantial evidence in the record that the claims of plaintiffs in the shareholders suits have validity. While that evidence does not amount to the quantum of proof that would be presented at a trial on the issues, it is not necessary that plaintiff-objectors prove their claims in order to defeat approval of a settlement that provides virtually no benefits. In weighing the validity of the claims and the benefits provided by the settlement, it is neither necessary nor desirable for the Court to try the case or decide any of the issues on the merits. Polk v. Good, 507 A.2d at 536.

The record in this matter is necessarily limited given the posture of the case and stage of the proceedings.

The only discovery prior to submission of the settlement for approval was that done in the Kahn action. That discovery was limited to production of documents and three depositions taken pursuant to court order on an expedited basis, prior to Kahn's motion for a preliminary injunction. Answers to a set of interrogatories and two depositions were also taken pursuant to court order in connection with the settlement hearing. In addition, counsel for the settling plaintiffs was deposed twice.

Even on the limited record available, there is substantial and compelling evidence that the challenged transaction was not the product of an informed and advised deliberative process. Rather, the uninformed and hasty approval of the transaction by the Special Committee, without benefit of independent legal or accounting advice, and the extraordinary size and questionable purpose of the contribution compel the conclusion that the Court below erred in determining plaintiffs' claims were so lacking in validity as to justify a finding that this meager settlement is fair and reasonable.

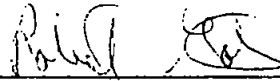
#### CONCLUSION

For the reasons set forth above, the order of the Court approving this stockholder derivative and class action settlement should be reversed.

Dated: October 18, 1990

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