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Trouble in Paradise

Battle for Getty Oil

A contract can be two things. A sheaf of papers stapled together with signatures at the bottom and the word "contract" typed across the top. But in the eyes of the law, a contract can also be a state of mind, something that may come into existence without paperwork and without lawyers. The main requirement, put simply, is that the parties achieve a *meeting of the minds* on the essential terms of the deal. In addition they must demonstrate their intent to be bound, perhaps by shaking hands, by putting up earnest money or maybe by hoisting a glass of champagne into the air. Bingo: A Contract.

Trouble in Paradise, The Battle for Getty Oil.......

For as long as ten hours they waited ---three hundred people packed elbow to elbow, hip to hip, in a seedy, turn-or-the-century courtroom built to accommodate roughly one-tenth their number. All decorum was laid aside. Anyone going to the bathroom took the risk of never regaining his place.

The mob had begun forming long before daybreak. So many newspaper reporters occupied the jury box that some crouched underneath and in between the swivel chairs. No one wanted to miss a single gesture or inflection by the star of the attraction.......... Judge Soloman Casseb Jr.

It was December 10, 1985, in Houston Texas – doomsday in a case called Pennzoil v. Texaco.

Three weeks earlier, a jury of eight women and four men had ordered Texaco Incorporated to pay $10.53 billion to Pennzoil Company, a sum greater than the GNP of 116 of the world's countries. In a stunning display of courtroom ingenuity that escaped virtually all public notice while it was happening, Pennzoil's legal team convinced the jury that Texaco had fraudulently induced Getty Oil Company to break a binding merger contract with Pennzoil, stealing a deal that would have given Pennzoil a billion barrels of choice oil reserves. The jury's verdict was remarkable even apart from the money involved; because by its own admission, Pennzoil had failed to secure a signed, formal contract for the deal. Yet after hearing four and one half months of testimony spanning twenty-four thousand pages of court transcript, the jury had taken barely two days not only to decide the facts, but to impose a fine ninety times larger than the greatest judgment ever to survive and appeal.

At 5:15 P.M. Judge Casseb, a seventy-year-old former divorce lawyer, resolutely climbed the bench, clutching a four-page document. A hush fell over the courtroom as he began reading and stumbling over words. Pennzoil, he said, shall receive from Texaco "the sum of seven thousand.......he caught himself..........seven billion, five hundred thirty million, as its actual damages.....plus $3 billion in punitive damages, plus interest, for a grand total of $11,120,976,110.83.

Judge Casseb proceededto sign the judgment and in barely a moment was gone, leaving the courtroom, and the world in a state of disbelief.

With Texaco, the sixth largest industrial corporation in America, standing on the threshold of bankruptcy, the greatest financial crisis in corporate history had began. HOW COULD IT HAVE HAPPENED?

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One truism has guided the oil industry for nearly a century: Oil is best when it is still in the ground. When you owned all the oil-in-the ground you could possibly obtain, everything else usually took care of itself. Want to borrow money? How much oil have you got in the ground? The banker would ask.

Want to sell some shares of stock? Same question from the investor. Oil occupied a special place in the world of international commodities. It was not like gold, which met its highest purpose dangling from someones's ears, or like wheat, which had to be consumed quickly or not at all. If you were an oilman, oil-in-the-ground was your portfolio, to be spent finding more oil in the ground.

Texaco never fully grasped this rule, choosing to make its fortune from refineries and filling stations rather than from finding oil fields. When a gusher came in, Texaco was often the first to lay a pipeline for buying everyone else's oil but often the last to put down a well of its own. Even when it tried, Texaco had little flair for finding oil. As any real oilman knew, the only place Texaco could find oil was in a filling station.

Nobody, however, could refine and sell oil products with the mastery of Texaco. Unlike other oil companies, Texaco had gasoline stations in all fifty states. Everything was fine as long as oil was plentiful enough to keep the refineries humming. By the time John McKinley had become chairman of Texaco, nobody had much oil to spare, and Texaco's supplies were shorter than anyone else's. It was theoretically possible that within a decade, Texaco's oil fields would be played out, dried up, bereft of crude. The Big Red Texaco Star was in danger of disappearing from the heavens-----unless, of course, Texaco could take over all the oil fields of a company like Getty.

If Texaco was behind its time coming to grips with the oil-in-the-ground rule, Hugh Liedtke of Pennzoil was ahead of his. From his earliest days in the oil patch, Liedtke had a knack for finding oil fields that flowed slowly but for a long time, where the oil had to be coaxed from the earth. This was just fine with Pennzoil, which, after all, sold oil by the quart, in little yellow cans. The only problem was, this patient strategy prevented Pennzoil from becoming a major oil company, from joining the ranks of Exxon, Mobil---or Getty oil.

Getty Oil was a thriving, diversified and highly profitable oil conglomerate created and guided, until his death in 1976 by the indomitable, J. Paul Getty. Although ranked 14th in the nation at that time in terms of size, it was ranked number six in terms of oil reserves (oil in the ground).

In the early 1980's unknown to the outside world trouble began to fester within the gilded walls of Paradise known as Getty Oil Company. Gordon Getty, one of the four sons of J. Paul Getty and a managing trustee of the Getty Trust which controlled 40% of the voting stock shares of Getty Oil Company was becoming increasingly at odds with the corporations board of directors. Over time the divide and distrust was so pervasive that knowledge of the rift began to filter to the outside world signaling that a head on collision was unavoidable.

Texaco and Pennzoil alike realized at about the same time that Getty Oil would make their cups runneth over. Neither had the time to try drilling for that much oil, but more importantly, neither had the money.

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John McKinley Chairman of Texaco, was born in Tuscaloosa, Alabama, on March 24, 1920, the grandson of a confederate soldier and the son of a onetime deputy sheriff who maintained the law with a sawed off shotgun from the back of a mule. His father later turned in his badge for a career in academia, graduating from Columbia and returning to Tuscaloosa to become a professor of industrial management at the University of Alabama. Young John became very much the product of his academic surroundings. Majoring in Chemical Engineering, attending classes year-round and remaining at home to complete a master's degree in chemistry. Following a tour in the military during WWII John returned home to accept a job with The Texas Company(changed its name to Texaco in 1957) as a young chemist, in Port Arthur, Texas.

John McKinley was young ambitious and well liked. He flourished with Texaco. By 1956 he had traded in his lab coat for a suit coat, and moved into the company's worldwide research headquarters in Beacon, New York. McKinley was on the Fast Track.

Texaco was born on the theory that it is better to sell someone else's oil than to go out and find some for yourself. Although based in Houston, Texas at the time the company was primarily owned by New York based investors who balked at the concept of expensive exploration versus contracting to purchase oil from other companies and piping it to their refineries. Eventually the New York investors made the decision to relocate the headquarters to New York City thereby consolidating all decision making away from the oil fields. The relocation of Texaco Headquarters forever changed its corporate character. It was virtually the lone Oil Baron among the financial titans on Wall Street. But back in the Oil Patch Texaco was rapidly becoming known as an outsider.

In 1979 John McKinley had earned his stripes and was elevated to the top position as Chairman and CEO of Texaco Oil Company as destiny begins to align the pieces of a complicated puzzle.

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John Hugh Liedtke Chairman of Pennzoil Corporation had a reputation for being hard nosed, aggressive, relentless and a fierce negotiator. He was born in Tulsa, Oklahoma on February 10, 1922, when it was still the oil capital of the world. Few families were more closely identified with Tulsa's oil roots than the Liedtkes. Hugh's father, William the son of Prussian immigrants who settled in one of the many German communities in Texas, had graduated from the University of Texas Law School and moved to Oklahoma when it was still Indian territory, helping to develop some of the earliest laws governing the ownership and extraction of petroleum. Hugh Liedtke got his first exposure to the oil patch as a fourteen year old boy. He was thrilled at the rough manly life of oil field men. Later his father sent Hugh and his younger brother William Jr. to Amherst College in Massachusetts, where after graduating Hugh then spent a year taking a compressed master's program in business administration at Harvard University. The Liedtke brothers then enrolled at the University of Texas Law School.

After graduation the brothers set up shop in the West Texas tumbleweed town of Midland in 1949. Before long the Liedtkes struck up a friendship with a Yalie and newly discharged Navy flier named George Bush. They later became business partners and in 1953 formed Zapata Petroleum Company with one million in capital which they had raised from friends and family. Zapata speculated in oil exploration by purchasing land leases and drilling wells in hopes of hitting a producer. They experienced an unbelievable streak of fortune by putting down 127 producers without ever encountering a dry hole. In 1954 they launched a for-hire drilling company, Zapata off-Shore, in the midst of a stock market boom that made it easier than ever to raise money from the public. By the late 1950's the young oilmen were millionaires many times over, but conflicts began to erupt between the Western investors who were brought in by the Liedtke brothers and the Eastern investors brought in by Bush. So in 1959, Bush's backers bought out the Liedtkes backers in the drilling company and the Liedtkes backers bought out the interest of Bush's backers in the producing company, and the two groups parted ways.

In 1960 while looking for a place to spend the dough he collected selling his share of Zapata off-shore, Hugh Liedtke came upon the name of a small Pennsylvania oil company called South Penn. South Penn was one of the survivors of the governments breakup of John D. Rockefeller's Standard Oil Trust in 1909. In 1955 South Penn had acquired Pennzoil, a California based company founded in 1913 and integrated it into its operation.
South Penn had what Hugh Liedtke really wanted, Oil-in-the-ground. It owned a piece of the famous Bradford field – the first billion-barrel oil field ever discovered. He decided that he ought to be running South Penn, and quickly identified a path into the company.

Liedtke put together an investment partnership and before long had bought 10% of the outstanding shares of South Penn. He then made a pitch to his friends Jack Roth and George Getty (son of J. Paul Getty) for help from the Old Man himself (J.Paul) who also owned 10% of South Penn.

On the strength of Liedtke's heavyweight backing, the board of South Penn eventually agreed to oust the company's chairman and CEO and installed the thirty-nine-year-old Liedtke as boss. Under Liedtke's leadership South Penn was hughly successful, soon doubling the company's stock value to

the extreme pleasure of it's most famous investor, J. Paul Getty. Getty eventually sold his interest to Liedtke who soon moved the company headquarters to Houston, Texas and changed the name to match its star product, Pennzoil.

Hugh Liedtke's life long ambition as an oilman was to grow his company to a size that could compete with the Big Boys.

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J. Paul Getty was one of the shrewdest and most successful American industrialist in the 20th century. Born in Minneapolis, Minnesota in 1892 he earned his first million in the oil fields of Oklahoma at the age of 24. The consonance playboy and financier, in 1917 he announced that he was retiring to become a full time Los Angeles-based playboy. During the Great Depression he very wisely bought numerous failing businesses which later helped to solidify his ranking as the wealthiest man in America.

Married five times, J. Paul had five sons, two of whom preceded him in death. Upon his death in June 1976 his fourth son Gordon Peter Getty, became co-trustee of the Getty Family Trust which was established by his grandmother in 1934 and owned and controlled 40% of the stock in Getty Oil Company. J. Paul did not trust Gordon's judgment and often stated that he had no business acumen so two additional co-trustees were appointed to provide a check and balance, Attorney Lansing Hays and Security Pacific Bank of California.

After the many hostile takeovers and the years of hoarding dividends J. Paul Getty had left behind quite a company. It owned oil wells from South China Sea to the North Sea, from the Arctic to the deserts of the middle east, with the densest concentration in the politically stable U.S. It had refineries on the East and West Coasts, and eventually some fourteen thousand five hundred gasoline stations in between. It had a copper mine in Arizona, vineyards and almond farms in California and choice commercial real estate all over the country. But all that paled next to its 1.5 billion barrels of oil-in-the-ground in the United States alone.

Following J. Paul's death the Board selected Sid Petersen, a top executive with the company to succeed him as President and CEO of Getty Oil. Peterson's strategy to grow the company through diversification immediately put him at odds with Gordon Getty who does not agree with this strategy and feared that it would ultimately dilute his equity in the corporation.

In 1983 after the sudden death of co-trustee Attorney Lansing Hays and the withdrawal of Security Pacific Bank ad co-trustee due to liability issues Gordon Getty unexpectedly becomes the only remaining Trustee of the Getty Trust with sole discretion to vote 40% of the Getty Oil Company Shares. Immediately Gordon Getty sees an opportunity to gain full control of Getty Oil as he begins to align himself with another major shareholder and plots a strategy to combine their voting power to oust the board and CEO Sid Petersen.

Petersen and Board fully anticipating this move by Gordon Getty, craft a two pronged counter-strategy designed to defeat any efforts on Gordon's part to take over the corporation. Their plan is to authorize the issuance of significant shares of additional stock there by diluting the effect of Gordon's voting shares with a back up plan of petitioning the courts to approve the appointment of an additional co-trustee for the Getty Trust as it was clear that J. Paul Getty's intent was that the Trust be overseen by more than one trustee.

Eventually the quest for control between the two warring sides became so intense and public that they finally agreed to execute a one year "Stand Still" agreement. Once executed each adversary would be bound to take no further action to gain control of the company. During the cooling off period management would seek a buyer at an agreed upon price point and if unsuccessful they would resign and yield control to Gordon Getty at the end of the "Stand Still" period.

Peace Alas..

Not quite, because before the formal "Stand Still" agreement was executed by both sides all hell broke loose.

Hugh Liedtke, Chairman of Pennzoil, fully aware of all the co-motion going on at Getty Oil had quietly assembled an acquisition/takeover team including his top managers, corporate attorneys and investment bankers in addition to arranging a $2 Billion line of credit while pledging every asset available. The team had quietly studied every detail of Getty Oil and put together a 24 page merger proposal which was ready for delivery just a few days before Christmas 1983.

After repeated attempts by Liedtke to schedule a face to face meeting with Gordon Getty and his attorney, Gordon finally consented to meet on the afternoon of New Years Day 1984 at his suite at the Waldorf.

Liedtke had correctly calculated that the tension between Gordon and the Getty Board, had made him receptive to a reasonable offer. Liedtke turned on his southern charm by talking about the early days in the oil fields and his successful dealing with Gordon's dad in the South Penn deal. He then presented his offer, which proposed to pay a $100 per share, would elevate Gordon to Chairman of the Board in addition to owning 4/7 of the new company. Liedtke would manage the day to day operations and if the deal was not working after one year, there was an unwind provision. Ultimately Gordon accepted the deal at $110 per share and they executed a five page Memorandum of Agreement.

The following day, January 2, 1984 at a regularly scheduled meeting of the Getty Oil Board, Gordon Shocked the Board as he presented the Memorandum of Agreement which he has hammered out with Pennzoil, recommending it for approval. After fierce discussions and negotiations the offer price was amended to $112.50 approved by the Getty Oil Board.
A quick call was placed to Hugh Liedtke who accepted the amended price without hesitation.

A joint press release was prepared and readied for release the following day..........

For immediate Release
Getty Oil Company, The J. Paul Getty Museum and Gordon P. Getty as trustee of the Sarah C. Getty Trust announced today that they have agreed in principle with Pennzoil Company to a merger of Getty Oil and a newly formed entity owned by Pennzoil and the trustee.....
The agreement in principle also provides that Getty Oil will grant to Pennzoil an option to purchase eight million treasury shares for $112.50 per share.
The transaction is subject to execution of a definitive merger agreement, approval by the stockholders of Getty Oil and completion of various governmental filing and waiting-period requirements.

Liedtke, soon boarded his private Jet for the return flight to Houston, content in the realization that he had finally achieved his dream........He was one of the Big Boys. Those billion barrels of oil were now practically his.

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In New York, as in many other jurisdictions, the formation of a contract generally requires something else besides a meeting of the minds and an intent to be bound. In case after case, for more than a century, the courts have found that a contract does not exist until parties have come to terms on each and every essential term of the deal .

On the morning of January 4, 1984 Bruce Wasserstein, co-head of mergers and acquisitions department of First Boston Corporation, listened with intrigue at the announcement of the pending merger between Pennzoil and Getty Oil. Based on his years of experience and knowledge of New York law he sensed an opportunity. This would be the biggest acquisition in history.

He immediately called one of the key players on the Getty Oil team and ask two questions....

Is there a deal yet? Followed by.....
If you had somebody who was willing to make a higher offer, would that be considered?

In the days that followed Bruce Wasserstein of First Boston Corporation successfully enticed and convinced John McKinley, Chairman of Texaco Incorporated and the Texaco Board of directors to approve a tender offer for the outstanding shares of Getty Oil Company.

The Texaco board approved a share offer of $125 for presentation to the Getty Oil Board, thus setting in motion the foundation for the largest corporate lawsuit in the history of our country.

Facts:

- **Pennzoil and Getty Oil entered into a merger agreement whereby Pennzoil would acquire Getty Oil. Pennzoil and Getty Signed a Memorandum of Agreement subject to the aplproval of each board and issued a joint press release.**
- **Texaco made an alternative offer to Getty's board. Getty repudiated its agreement with Pennzoil and accepted Texaco's offer.**
- **Pennzoil sued Texaco for tortious interference with contract. Texaco asserted that the Memorandum of Agreement was not a binding contract because it was subject to the approval of Getty's board of directors and would expire by its own terms if not approved. Pennzoil asserted that the contract was binding because the Memorandum had been executed by a group of parties that controlled the majority of outstanding shares in Getty Oil. The Jury returned a verdict for Pennzoil and Texaco appealed.**

Before judgment could be entered in the Texas court and Pennzoil could obtain a lien, Texaco filed a suit in the U.S. District Court for the Southern District of New York, alleging that the Texas proceedings violated Texaco's constitutional rights. The District Court found for Texaco, and the Second Circuit Affirmed.

Pennzoil appealed the federal court case to the United States Supreme Court. The Supreme court reversed the circuit court decision, on the grounds that th New York court should have abstained interfering with the decision of a state court.

Texaco also appealed the Texas state court decision. The Texas Court of Appeals upheld the jury verdict, but found that the trial court has abused its discretion by not suggesting a reduction of damages. It would allow the verdict to stand if Pennzoil filed a reduction in damages of two billion dollars, making the punitive damages award $1 Billion. Compensatory damages of $7.53 billion remained unaffected. Pennzoil paid its lead Attorney Joe Jamail $335 million for the victory.

After Texaco filed for bankruptcy, Pennzoil agreed to settle the case for $3 billion.

What constitutes a binding contract?