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Inside Wealth

Are C.E.O.s That Talented, or Just Lucky?

Harold Hamm claimed in his divorce case that under 10 percent of his wealth was a result of skill and effort, and that mostly he rode the crest of oil prices and the slide.Credit...Matt Hawthorne

By Robert Frank

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The divorce of the oil billionaire Harold G. Hamm from Sue Ann Arnall has gained attention largely for its outsize dollar amounts. Mr. Hamm, the chief executive and founder of Continental

Resources, who was worth more than $18 billion at one point, wrote his ex-wife a check last month for $974,790,317.77 to settle their split. She's appealing to get more; he's appealing to pay less.

Yet beyond the staggering sums, the Hamm divorce raises a fundamental question about the wealth of executives and entrepreneurs: How much do they owe their fortunes to skill and hard work, and how much comes from happenstance and luck?

Mr. Hamm, seeking to exploit a wrinkle in divorce law, made the unusual argument that his wealth came largely from forces outside his control, like global oil prices, the expertise of his deputies and other people's technology. During the nine-week divorce trial, his lawyers claimed that although Mr. Hamm had founded Continental Resources and led the company to become a multibillion-dollar energy giant, he was responsible for less than 10 percent of his personal and corporate success.

Some in the courtroom started calling it the "Jed Clampett defense," after the lead character in "The Beverly Hillbillies" TV series who got rich after tapping a gusher in his swampland.

In a filing last month supporting his appeal, Mr. Hamm cites the recent drop in oil prices and subsequent 50 percent drop in Continental's share price and his fortune as further proof that forces outside his control direct his company's fortunes.

Lawyers for Ms. Arnall argue that Mr. Hamm is responsible for more than 90 percent of his fortune.

While rooted in a messy divorce, the dispute frames a philosophical and ethical debate over inequality and the obligations of the wealthy. If wealth comes mainly from luck or circumstance, many say the wealthy owe a greater debt to society in the form of taxes or charity. If wealth comes from skill and hard work, perhaps higher taxes would discourage that effort.

Sorting out what value is created by luck or skill is a tricky proposition in itself. The limited amount of academic research on the topic, which mainly looks at how executives can influence a company's value, has often found that broader market forces often have a bigger impact on a company's success than an executive's actions.

"As we know from the research, the performance of a large firm is due primarily to things outside the control of the top executive," said J. Scott Armstrong, a professor at the Wharton School at the University of Pennsylvania. "We call that luck. Executives freely admit this — when they encounter bad luck."

A study conducted from 1992 to 2011 of how C.E.O. compensation changed in response to luck or events beyond the executives' control showed that their pay was 25 percent higher when luck favored the C.E.O.

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Steve Sisney/Reuters

Some management experts say the role of luck is nearly impossible to measure because it depends on the particular industry. Oil, for instance, is especially sensitive to outside forces.

“Within any industry, a more talented management team is going to tend to do better,” said Steven Neil Kaplan of the University of Chicago Booth School of Business. “That is why investors and boards of directors look for the best talent to run their companies. That is why company stock prices often move a lot, in both directions, when a C.E.O. dies or a new C.E.O. is hired.”

The Hamm case hinged on a quirk in divorce law known as “active versus passive appreciation.” In Oklahoma, and many other states, if a spouse owns an asset before the marriage, the increase in the value of an asset during marriage is not subject to division if the increase was because of “passive” appreciation. Passive appreciation is when an asset grows on its own because of factors outside either spouse’s control, like land that appreciates without any improvements or passively held stocks. Any value that’s not deemed as “passive” is considered “active” — meaning it increased because of the efforts, skills or funding of a spouse and can therefore be subject to division in a divorce.

The issue has been at the center of some other big divorces. In the 2002 divorce of the Chicago taxi magnate David Markin and Susan Markin, filed in Palm Beach, Fla., Mr. Markin claimed he was “merely a passenger on this corporate ship traveling through the ocean,” according to the judge. But he ruled that Mr. Markin was more like “the captain of the ship. Certainly he benefited by sailing through some good weather. However, he picked the course and he picked the crew. In short, he was directly responsible for everything that happened.” Ms. Markin was awarded more than $30 million, along with other assets.

Mr. Hamm, now 69, also had favorable conditions after founding Continental Resources well before his marriage in 1988 to Sue Ann, then a lawyer at the company. By this fall, when the trial ended, Continental had a market capitalization of over $30 billion; Mr. Hamm’s stake of 68 percent and other wealth exceeded $18 billion.

Their divorce trial was closed to the public, and all but a few of the documents are under seal. Neither Mr. Hamm nor his lawyers or representatives would comment. Ms. Arnall and her spokesman also declined to comment.

According to people with knowledge of the case, however, Mr. Hamm's chief strategy was to claim most of his wealth as passive appreciation, and therefore not subject to division. During his testimony, the typically commanding Mr. Hamm, who had been the face of the company for decades, said he couldn't recall certain decisions, didn't know much about the engineering aspects of oil drilling and didn't attend critical meetings.

Mr. Hamm's lawyers calculated that only 5 to 10 percent of his wealth came from his own effort, skill, management or investment. It's unclear how they squared this argument with his compensation, which totaled $42.7 million from 2006 to 2013, according to Equilar, an executive compensation data company.

Ms. Arnall called more than 80 witnesses — from Continental executives to leading economists like Glenn Hubbard and Kenneth Button — to show how much better Continental had done than its peers and that Mr. Hamm made most or all of the key decisions about the company's strategy, finances and operations. They estimated that Mr. Hamm was responsible for $14 billion to $17 billion of his $18 billion fortune.

The judge's ruling in November largely sided with Mr. Hamm and awarded Ms. Arnall about $1 billion, a fraction of what many divorce experts had expected.

"It was surprising," said Jeffrey D. Fisher, the Florida divorce lawyer who represented Susan Markin. "But when you're dealing with numbers that high, there are times when the court just says, 'Enough is enough.' "

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