Sons of Wichita

HOW THE KOCH BROTHERS
BECAME AMERICA'S MOST POWERFUL
AND PRIVATE DYNASTY

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with heart trouble. He suffered a major heart attack in mid-1967 that left him hospitalized for two months. Not long after he was released, the industrialist cajoled his doctor for clearance to go hunting, which the physician finally granted.

That November, Fred accompanied his close friend R. C. "Mac" McCormick, owner of Wichita's Broadview Hotel, on a hunting excursion to Utah. On November 17, Fred was in a duck blind near the Bear River, accompanied by a gun loader. He hadn't shot well all day. When a solitary duck flew overhead, Fred tracked the bird with the muzzle of his shotgun. He aimed, then squeezed the trigger. The bird stopped in mid-flight and fell from the sky.

"Boy, that was a magnificent shot," the industrialist managed to say. Then he collapsed.

CHAPTER FIVE

Successor

"His death threw responsibility for his interests on one of his four sons, Charles," read Fred's obituary, two days later, in *The Wichita Eagle*. The claim was accurate, but it understated the reality. In an instant, Charles had hurtled from his father's protégé to his successor. Now Charles, who had just turned thirty-two, ruled the empire. He was petrified.

Fred had effectively turned the company over to his son a year earlier, but had remained close at hand to provide advice and instruction, even if Charles ignored it. He had been his son's backstop and sounding board. Now Charles alone held the family's future in his hands.

The Monday after Fred's death was clear and temperate. Shortly before 2:30 p.m. mourners gathered in the chapel of the sterile-looking Downing & Lahey Mortuary, a short drive from the Koch family's home. Friends, family, and business associates packed the pews. Some of Fred's John Birch Society pals, including Clarence Manion, onetime dean of Notre Dame's law school and a popular right-wing radio host, traveled from out of town to pay their respects.

"A man of modesty, he was never impressed with flattery," eulogized Pastor Rang Morgan, of Wichita's Sharon Baptist Church, at the service. "He used to say to me, 'Rang, flattery is much like perfume. It's o.k. to inhale it; but don't ever swallow it.'"

The pastor referred briefly to Fred's crusade against communism, saying, "I'm sure that Fred Koch had enemies for no man makes such a stand for that which is right as he did, without making enemies along the way.

"One had only to be associated with this man for a short while to know how he felt about his business," he went on. "He felt that there were no short cuts to success; and that no business could be successful unless there was a total loyalty from all associated with it."

After their father's funeral, Bill, Charles, and David boarded a small plane, flew up above the Flint Hills, and scattered their father's ashes above the rolling acreage of his beloved Spring Creek Ranch.

Later, while setting his father's affairs in order, Charles unearthed a letter Fred had written on a cold January day in 1936, two months after Charles's birth and when Frederick was three. He told his sons that they would one day inherit a "large sum" of money and he imparted his wisdom regarding their inheritance:

> It may be either a blessing or a curse. You can use it as a valuable tool for accomplishment or you can squander it foolishly.
>
> If you choose to let this money destroy your initiative and independence then it will be a curse to you and my action in giving it to you will have been a mistake. I should regret very much to have you miss the glorious feeling of accomplishment and I know you are not going to let me down.
>
> Remember that often adversity is a blessing in disguise and is certainly the greatest character builder. Be kind and generous to one another and be good to your mother.

Despite his words about being "kind and generous to one another," the terms of the businessman's will planted the seeds of resentment. Almost a year to the day before he died, Fred had

scrawled his signature on an updated version that excluded Frederick from the same inheritance as his three younger brothers. Fred didn't leave his eldest son a pauper; he had created two trust funds for him, one in 1961 and the other in 1966. But Fred was determined that he receive nothing more.

Their father removed Frederick from his will, according to Charles, because he had repeatedly stolen from him in the years before his death "and then lied about it when confronted with the evidence." Frederick lifted traveler's checks, cash, and an "air travel card" from their dad, Charles said; in one case, he alleged, his older brother forged his signature on their father's Brooks Brothers charge account.

According to Charles, on the first occasion Fred caught his son stealing, he forgave Frederick. Indeed, Fred included Frederick in a previous version of his will, drafted in June 1966. But later that year, after Fred had created trusts for each of his sons, the industrialist discovered that Frederick had again stolen from him. "The fact that...he in the face of that would steal from him again was the final straw," Charles said. ("I refute all of Charles' allegations as a calculated campaign of vilification," Frederick said. "He who would cast aspersions should be beyond reproach.")

Frederick learned of his disinheritance when he returned home for Fred's funeral. His grief-stricken mother—unaware of Frederick's removal until she read her husband's will—broke the news to him in the library of the family's home. Frederick recalled that she asked him not to contest the will and "said that she would never favor one son over the other when it came time for her to write her will and that all her sons would be treated equally." Deeply embittered, he pressured his mother in the years ahead to make things right. "I have never forgotten your saying, shortly after father died, that you intended to leave me a share in your estate equal to that of my brothers," he wrote Mary in May 1972. "You asked me at that time not to contest father's will." He'd obliged, believing his mother "would set things straight eventually." But this had yet to happen. Frederick asked Mary to create a second trust to put him on a more even footing with his younger brothers. Doing so, he said, would "no longer perpetuate an imbalance that reflected father's unequal affection for his children."

Mary resisted Frederick's efforts to extract more money from the family, replying by letter that his father had left him an "adequate" trust. Though he was left out of Fred's will, Frederick still owned a little more than 14 percent of the stock in his father's company and 16 percent of the shares in a charitable foundation Fred had established in 1953. Charles, David, and Bill each inherited 20-plus percent stakes in the company (the rest was owned by other family members, including the descendants of L. B. Simmons) and nearly 23 percent apiece of the foundation. Fred left to his wife their property and all of his possessions, including their art collection.

Though they owned an equal share of their father's company, Charles, David, and Bill were not equals in the family business. Fred anointed Charles as his professional heir. He had control of the company, and he could run it as he pleased. After Fred's death, a number of the industrialist's friends counseled Charles to sell his father's corporate assets, believing there was a good market for them. At the time Fred's holdings included four ranches; a crude oil gathering and refining business; some minor oil exploration interests; and Koch Engineering Company, the outfit Charles had turned around in the early 1960s, which sold equipment to international oil industry customers.

Charles politely refused those who advised him to sell. "Charles told me that he wasn't going to do that," Sterling Varner recalled, "that he'd seen a lot of companies in the second generation disappear. They would either go broke or sell out.... So he set his mind to make this company grow and prosper, and he told me that he was going to devote his life to it."

Charles remembered: "I was scared, but I also thought we had a lot of opportunities." He planned to "take the foundation we had, particularly the spirit, the attitude, and the values, and compete with major oil companies—compete with all the major...companies that were in the businesses that we were in."

Charles had inherited not just the reins of the company, but also his father's reticent, press-shy nature. The beauty of running a private company, Charles often pointed out, was that you didn't have to bare your soul to the public and financial regulators, tipping off your competition to your strengths and weaknesses in the process. ("We don't typically want to broadcast what we're doing," he once explained.) But on June 27, 1968, Charles did something that seemed unthinkable: He convened New York City's financial media for a press conference, where he announced that he planned to consolidate Fred Koch's business empire and rename the company Koch Industries in his father's honor. In another first, Charles also unveiled the company's impressive size. With $250 million in annual sales (roughly $1.7 billion in today's dollars), it ranked among the largest privately owned companies in America. And it was aggressively growing.

"Our change of corporate identity, and the corporate realignment accompanying this change, symbolize the new thrusts of activity within all divisions and subsidiaries of Koch Industries Inc., which will add at least $30 million in gross sales in 1968," the executive said.

The following year, Charles engineered one of the most important deals in the company's history, an acquisition that powered the businessman's expansion plans for years to come. A decade earlier in 1959, when a 35 percent interest in the Great Northern Oil Company had come on the market, Charles's father had plunked down nearly $5 million without hesitation. It was a wise investment. The company owned a lucrative 40,000-barrels-per-day refinery, known as Pine Bend, near the Twin Cities. It had easy access to a steady supply of Canadian crude and little in the way of competition in the upper Midwestern market.

Fred's investment would ultimately lead to a longstanding relationship between the Koch family and one of its most important business allies, the Marshall clan. J. Howard Marshall II was an oilman and attorney who had cofounded Great Northern in 1954. Fred had gotten to know him during World War II, when Marshall served as chief counsel to the Petroleum Administration for War. (Marshall today is better remembered for his marriage, at age eighty-nine, to *Playboy* playmate and stripper Anna Nicole Smith.) Marshall, whose friendship with Fred solidified when the Wichita businessman bought into Great Northern, owned 16 percent of the company.

In the late 1960s, Union Oil Company of California, owner of a 49 percent stake in Great Northern, was sniffing around for a buyer, and Charles glimpsed an opening to consolidate control. "Charles had all of his father's ability plus some," Marshall remembered.

Charles knew the Pine Bend refinery well; he had worked there in his mid-twenties. He approached Marshall with a plan to exchange his Great Northern stock for Koch Industries shares; then, with 51 percent owned by Koch Industries, he acquired Union Oil's shares for $30.5 million, giving Koch Industries total control of the company.

"I generally do not like partners, but Howard Marshall is an exception," Charles told the veteran oilman after the stock swap, according to Marshall. In this case, the upside of controlling Pine Bend outweighed the perils of bringing an outsider into the strictly family-owned company. The ideally located refinery was a cash cow—as Koch executives themselves later described it—that fueled subsequent acquisitions.

Charles wanted to branch out beyond the traditional businesses in which his father had operated. "Charles had been pressing for

a long time to get into the chemical business," Varner recalled. He also positioned the company, which had hewed strictly to the oil business, to enter related sectors including natural gas and gas liquids, such as butane and propane. Before long, Varner said, "we were handling around a fifth of all the propane in the United States."

The key with all these products was transporting them, so Koch Industries concentrated on building its pipeline and trucking capacity. And the company's healthy appetite for risk enabled it to beat out competitors vying for access to the product. "We were willing to build a pipeline into a new field without a commitment from the producers as soon as there was any indication it would be economic," Charles recalled. "Other pipeline companies typically attempted to reduce their risk by requiring a commitment, a reserve study, and a fixed tariff."

In the years to follow, Koch Industries followed a business model that might have appeared scattershot to outsiders: Koch would move into animal feed and agriculture, highway and tennis court surfaces, and telecommunications. Koch was perceived as an oil company, but Charles viewed the enterprise through a different lens. He made investments based purely on the company's core capabilities—the ability to transport, process, and trade commodities.

Executives who had worked for his father quickly noticed their differing styles. Fred occasionally allowed sentimentality to influence his business decisions, whereas his son focused relentlessly on profit margins. Fred's move into ranching—based partly on the natural beauty of the tracts he was buying and his frontier childhood—was one example of this. On one occasion, faced with the decision of buying a ranch that neighbored Beaverhead in Montana, or spending the same amount on an industrial Caterpillar tractor, Fred opted for the tractor, even though he realized that purchasing the land made more business sense. "I have wanted one of those big tractors all my life, so let's buy it anyway," Fred explained.

Faced with the same choice, Charles would have made a different calculation, though he did have a certain soft spot for the ranches where he had toiled during his youth. On a few occasions, Charles resolved to sell off the properties, which were less profitable than other businesses Koch Industries was involved in. But in the end, "he always priced them way above the market so they would not sell," Varner said.

Charles's business sense wasn't always on target, and in his first years of running Koch Industries, he occasionally steered the company into blunders. The most memorable occurred in the early 1970s when Koch Industries, following the lead of its competitors in the oil market, gambled big on supertankers. It bought five tankers and chartered a host of others just as the market cratered, leaving Koch on the hook for millions—nearly $500 million, one board member told *Fortune*—as the company scrambled to extricate itself from the collapsing business. All that remained of the disastrous endeavor was the ship's bell from the *Mary R. Koch*, the tanker Charles had named after his mother, which he later presented to her after the vessel was sold at a huge loss.

Charles's emphasis on growth and laser-like focus on profit were not rooted in a desire to become one of the world's richest men. The spark that drove him to build his company and keep building it came from a different place. "He doesn't do it to make money, never has," said Tony Woodlief, the former Koch Industries management consultant. "It's always just been a great, big fascinating puzzle. He's most excited when they've solved some problem. 'Golly, we buy this shipping terminal and start producing this product and holy cow, we now have an international distribution network. That stumped everybody for fifty years and we figured it out.' That's what he likes."

"It's always been the discovery that turns him on," he continued. "And that's why he made all the money.... He just loves the discovery and the wealth followed."

Pursuing expansion with his signature intensity, Charles worked six, sometimes seven days a week and expected the same of his inner circle. He grew so accustomed to fielding middle-of-the-night calls from employees operating in different time zones that one evening he awoke from a deep sleep believing the phone was ringing and walked out of his bedroom to answer it. He realized a few moments later that he had dreamt the call—and was now standing in the hallway of his apartment building in his underwear. Charles even designed his exercise regimen—he ran a few miles several days a week—so it wouldn't detract from his productivity. "My objective," he once said, "is to get the most exercise in the shortest possible time."

Charles often seemed oblivious to the demands he placed on his employees. In August 1968, in an episode executives still shook their heads at years after the fact, he convened a meeting on a Sunday afternoon that ran until midnight.

But his methods worked. The company was growing at a head-spinning pace. Charles had inherited an enterprise with 650 employees and a value of about $50 million. Over the next fifteen years, Koch Industries' value rose to $1.5 billion and the company employed 7,000 people. Its small group of shareholders reaped the rewards of this growth in dividend checks that kept adding zeros, increasing from the thousands into the millions; the year of Fred Koch's death, the company paid out less than $300,000 a year. By the early 1980s, the Koch brothers and the other shareholders divided up a pot of close to $28 million.

Even though Charles, as Koch's chairman and CEO, charted the direction of the company, it remained a family enterprise. By the late 1960s, Bill and David had joined the company's board of directors and took a more active role in plotting its future course.

At the time, Bill was still in Boston, completing a doctorate in chemical engineering at MIT; David had moved to New York City, where he worked as a junior engineer at a chemical company.

Frederick, as in childhood, remained the odd man out. His 14 percent interest in the company entitled him to a board position of his own, but he elected not to get involved with the management of Koch Industries. This was just fine with Charles, whose relationship with his older brother was distant at best. "Frederick and I had quite different interests, so we were never close," he once explained. But this was an understatement. Charles held his bon vivant brother in contempt. "Over the years," Charles once said, "I had accepted my father's analysis of Freddie of not really being a whole person, of being a person who was amoral and not capable of true feelings towards other people."

As Charles had made clear to J. Howard Marshall, he disliked partnerships, especially with people he didn't trust—like Frederick, a wild card. He displayed no interest in the company's affairs now, but what about in the future?

Eight months after their father's death, Charles made a play for Frederick's shares, but in doing so he badly underestimated his older brother. During the summer of 1968, Charles made an appointment to visit Frederick to discuss the possibility of acquiring his stake. Befitting their cool relationship, they convened in formal fashion at the midtown office of Frederick's attorney S. Hazard Gillespie, a partner with the white-shoe law firm of Davis, Polk & Wardwell.

Gillespie was a legal legend, who in the late 1950s and early 1960s served as the U.S. Attorney for the Southern District of New York, where he was known for his aggressive prosecution of securities fraud and for unsuccessfully making the government's obscenity case against *Lady Chatterley's Lover.* In private practice, the bow-tie-wearing litigator represented a string of high-profile clients, including actresses Mary Pickford and Tallulah Bankhead.

Charles had worked out what he considered a fair price for Frederick's holdings, $120 per share. He handed Gillespie a document on which he had calculated how much annual interest the proceeds would accrue if invested in various mutual funds—that is, how much yearly income Frederick would have to live on. Why keep his money tied up in a private company like Koch Industries, Charles seemed to be suggesting, when Frederick could make a tidy living investing in the public markets?

Frederick heard Charles out, but found his brother's effort to separate him from the stock their father had gifted him rather brazen. "I thought it was presumptuous of a younger brother to map out my financial future for me," Frederick recalled.

Gillespie had commissioned a study of Frederick's holdings, based on years of financial statements, in advance of the meeting. The lawyer told Charles that this review had determined that Frederick's stock could be worth up to three times what Charles was offering. With that, Gillespie picked up the document Charles had handed him, and, with the young executive watching, theatrically dropped it in a waste bin.

"Goodbye," the lawyer said coolly.

David officially joined the family company in 1970, taking a mid-level position, at a salary of $16,000 a year, as the technical service manager at Koch Engineering, the same division where Charles got his feet wet in the family business. Unlike his older brother, who was summoned home to learn the ropes, David was spared from returning to Wichita; he established an office in Manhattan.

After college, David and Bill each earned master's degrees in chemical engineering from MIT. From there, David entered the working world, while Bill remained in graduate school. David's first job, in 1963, was as a research engineer for a Cambridge-based company called Amicon. He went on to spend three years at Arthur D. Little, the consulting firm where Charles had gotten his start, developing cigarette filters and conducting engineering feasibility studies.

David had a reputation as a hardworking playboy, who enjoyed regaling friends and dates with tales of exotic travel—polar bear hunting in the Arctic Circle, stalking boar in the Hungarian countryside. *The Boston Globe*'s "Hobbledehoy" column captured his globe-trotting persona in 1967: "Dave Koch of Cambridge, who works at Arthur D. Little and plays just about everywhere, just returned from three weeks of traveling in Switzerland and Germany with a store of gamesman-like remarks." Among his Gatsbyesque pronouncements: "St. Moritz is to the Alps as St. Tropez is to the Riviera." And: "Kitzbuhl's where the swingers are, but the good skiing is at St. Anton."

Later that year, David left the Boston area for the more glamorous metropolis of New York, a city crowded with other wealthy heirs who held their own turgid opinions on St. Moritz and Kitzbühel. He went to work for the chemical company Halcon International, and its subsidiary, Scientific Design. Some of his coworkers knew of his wealthy background, but he didn't seem to possess a noticeable air of entitlement. What colleagues noticed most was his intellect and work ethic.

"David was a sponge for information," one of them recalled. "He came knowing almost nothing. And he tried to learn everything he could possibly learn. He worked as hard as anybody, in fact probably harder than anybody."

David often worked late into the evenings. During the summer months, his Park Avenue office building shut off the air-conditioning at 5:00 p.m. As the sun went down, David could often be found in his office, stripped down to his boxer shorts and a T-shirt, plunking away at his calculator. In 1970, after the company denied David's request for a transfer to the company's sales department ("he wasn't the sophisticated man he now is," the colleague said), he joined Koch Engineering, where before long he was selling products to his former employer.

Charles had put the once-struggling engineering subsidiary firmly into the black, but Sterling Varner credited David ("very technical, but also sales oriented") with transforming Koch Engineering from a relatively small company into a "world-wide business." Rising over the next decade to vice president and then president of Koch Engineering, David expanded its limited repertoire to include a host of product lines that catered to the petrochemical industry, including an assortment of internal components for the fractionation towers used by oil and chemical companies.

In 1977, David's responsibilities expanded to include running Koch Membrane Systems, a company that specialized in wastewater treatment technology. The subsidiary was located in Wilmington, Massachusetts, a northern suburb of Boston. Originally called Abcor, the company had been started by MIT professors, including Ray Baddour, one of Bill's chemical engineering teachers. Bill had convinced Charles to invest in the business, which Koch Industries later acquired outright.

Running Koch Membrane required David to spend at least a couple days a week in the Boston area. When he was in town, he typically bunked with Bill, who had remained in Massachusetts after completing a doctorate in chemical engineering. Bill had joined the family business in the mid-1970s; by now he ran a new subsidiary called Koch Carbon, through which Koch Industries hoped to gain a foothold in coal mining and the trading of petroleum coke. Known within the energy industry as "petcoke," the carbon residue created through the refining process had a market of its own as a coal-like fuel source. "I took great pride in working in my father's company with my brothers," Bill recalled.

The three brothers were working together, expanding their father's business in ways that he couldn't have imagined. They were tasting the "glorious feeling of accomplishment" Fred Koch had always wanted his sons to experience for themselves. It was, for the moment, exactly how Fred would have wanted it.

In late 1972, a wave of relief rippled through the senior ranks at Koch Industries as word spread that Charles, then thirty-seven, had gotten engaged. This meant that overworked executives might finally get to spend a little more time with their families.

To say that Charles was a workaholic underplayed the depth of his addiction. He spent what spare time he had studying heady books on economics, philosophy, and organizational psychology, amassing knowledge that he could channel into Koch Industries. Charles wanted to show the world that he wasn't just a trust fund kid who had been handed the keys to the kingdom; he was an empire builder in his own right.

"He almost killed us, because this was his whole soul," Varner remembered. "He worked long hours, weekends, holidays. He finally got married, and we were delighted to see that because he stopped working weekends."

Elizabeth Buzzi was nine years younger than Charles. When they met in 1967, the twenty-three-year-old had already been married once before. A petite, pretty blonde, Liz had a feisty nature and the profanity-laden vocabulary of a longshoreman. She had attended Catholic school in Wichita and an all-women's college in Columbia, Missouri. She hailed from a well-off family of her own, though nothing like the Kochs. The Buzzis owned a chain of department stores called Hinkel's, which, from its flagship location in downtown Wichita, had expanded into Texas, Oklahoma, and New Mexico.

Their engagement wasn't exactly storybook. Charles delivered his marriage proposal with businesslike efficiency, over the phone and while paging through his calendar for an opening in his schedule. The couple had dated for five years. Charles and Liz had

decided, family friend Nestor Weigand explained, "Well, within five years, we're either going to be married or we'll break up." In 1972, when their fifth anniversary approached, "They had a private discussion. 'This is the fifth year. Are you a person of your word or what is this?' Bang! They were married like that." The couple, who married two days before Christmas, wed so quickly that an already-planned ski vacation to Vail with Weigand and other friends doubled as their honeymoon.

After their marriage, the couple moved into a five-bedroom, nine-bath contemporary-style house that Charles built on the compound where he grew up, near his childhood home, where his mother still lived. Charles's friends credit Liz with drawing him out of himself, and opening the aperture on his narrow life, in which there had been room for little other than Koch Industries business. "Charles would no question have been very successful if he hadn't met Liz, if he'd remained a bachelor, but Liz brought a sense of reality, if you will, to him," his friend Leslie Rudd said. "She brought Charles down to earth. I think he lived a normal life because of Liz.... She's important to making him the kind of person he is."

Charles has said: "I am so goal-oriented that I can get withdrawn from relationships, and Liz really taught me how to have a close, loving relationship."

The birth of their children, Elizabeth Robinson in October 1975 and Charles Chase in June 1977, also added a new emotional dimension to his life. Like his own father, he worried that privilege would corrupt the initiative of his children; he lectured them often about his value system, including on Sunday afternoons, when Charles subjected his kids to lengthy discourses on economics.

"Whatever they participated in, they needed to participate the best they could," Weigand said. "And it didn't mean that they had to be the best at it, but they had to work to the maximum of their own abilities." But Charles was not his father. He was the kind of dad who didn't miss Chase's Biddy Basketball games at the local YMCA and encouraged Elizabeth's interest in literature. Charles's kids, Weigand said, got the kind of love "that Fred, being the John Wayne that he was, didn't have the ability to articulate or to express. Because [Charles's] kids understood the love part."

Outside of the firm and his family, there was a third crucial influence on the CEO's life. It not only changed the way Charles saw the world, but it inspired him to embark on a lifelong crusade to change the world itself.

CHAPTER SIX

Rise of the Kochtopus

On a summer day in the early 1960s, Charles drove up a rutted dirt road that climbed into the heavily wooded foothills of the Rampart Mountain Range. Dense with second-growth Douglas firs and Ponderosa pines, the steep terrain rose 1,000 feet in elevation in the space of a quarter-mile. Nestled into this pastoral tableau, located midway between Colorado Springs and Denver, were a handful of log cabins sited near a long, three-story lodge.

With its gurgling brook, horse stables, and walking trails, the compound looked like a sleep-away camp. In fact, it was a libertarian mecca, where freedom seekers from around the world made pilgrimages to learn at the feet of a gray-haired, bolo-tie-wearing guru. More than a few attendees of the intensive two-week sessions at Robert LeFevre's Freedom School, who prior to their enrollment had perhaps experienced faint stirrings of libertarian identity, emerged as fierce free-market crusaders.

Though LeFevre was the primary instructor, the school's cast of guest lecturers during the 1960s included movement luminaries such as University of Chicago economist and future Nobel Prize winner Milton Friedman, a vocal foe of the Keynesian approach to economics, in which government plays a central role in guiding the economy; Leonard Read, founder of the Foundation for Economic Education, a pioneering free-market think tank; and the journalist Rose Wilder Lane (daughter of Laura Ingalls Wilder of