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How an Oil Theft Investigation Laid the Groundwork for the Koch Playbook

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How did the Koch Brothers become the Koch Brothers? The oil-company heirs had long held small-government, anti-regulation beliefs, but weren't always deeply enmeshed in the political world—until 1988, when the U.S. Senate began looking into allegations their company was stealing oil from Indian reservations in Oklahoma.

For his new book, KOCHLAND, author Christopher Leonard unearthed the full story of what happened, from the workers under-reporting their oil pickups to the network of front groups, training centers and political operatives that the Kochs built to fend off the investigation—and which today have come to be both respected and feared in American politics.

On July 11, 1988, the president of Koch Industries, Bill Hanna, sent a companywide memo informing employees how to handle company records. He reminded employees at the oil company that there was a code of secrecy for internal records. Then, he ordered that “written materials which would be useful to our competitors should be destroyed by shredding, burning, or some equally effective method.”

At any other time, Hanna’s memo might have been standard advice for a secrecy-minded company. Coming when it did, it could also be seen as a license to destroy evidence.

The U.S. Senate had just launched an investigation into Koch Industries for stealing oil from leases on Indian reservations. At the time, Koch Industries was the biggest purchaser of crude oil in the country, and Senate investigators believed that the company was stealing from its producers by misreporting how much oil it picked up from their wells. The allegations would be confirmed or disproven in part by the very documents Hanna was allowing to be destroyed. Under such circumstances, corporate lawyers and executives often order their employees to take special care to retain records that might be relevant to a lawsuit or investigation. Koch Industries did the opposite. It is unknown how many documents were destroyed because of that memo.

Don Cordes, Koch Industries’ general counsel, eventually reversed course and told company employees to retain evidence that might pertain to oil theft, but he didn’t do so until November of 1988, months after Hanna’s memo went out. The only reason that Cordes changed the policy was because an employee in Texas complained to Cordes that he had been told to destroy all written evaluations he had made of Koch Industries’ truck drivers and oil gaugers.

The investigation had been launched in October of 1987 by the Senate Select Committee on Indian Affairs after a series of articles in the *Arizona Republic* alleged that big oil companies were stealing oil from Native Americans who owned oil wells. When the companies picked up

crude oil from wells to take it to market, they falsified receipts to make it look like had picked up less oil than they really did, or that the oil was of a lower quality than it really was. The Senate hired prosecutor Ken Ballen to lead the investigation. He quickly sent out subpoenas and started building a case that not only would go on to last years but would also transform U.S. politics.

The Senate investigation intensified during 1989. As evidence came rolling in, it pointed in one direction, Ballen recalled later during an interview. Koch, more than any other company, had falsified tickets and taken more oil than it paid for. (The company later admitted in court that it collected about \$10 million in crude oil each year without paying for it.) When Ballen's team reviewed reams of records from big oil companies, Koch Industries' records stood out—no other company had collected so much oil without paying for it. Senate investigators believed that Koch Industries had been caught red-handed, and the other companies had not. (Ballen said that a few other instances of oil theft were discovered, but they were isolated incidents perpetrated by very small companies.) Ballen said other oil companies were so frustrated with the company that they allowed Ballen's investigators to access their private land, setting up surveillance of Koch Oil employees as they picked up oil. FBI Special Agent Jim Elroy did just that, hiding behind herds of cattle to snap surveillance photos. Elroy caught Koch Industries employees falsifying documents to underreport how much oil they'd taken.

In May of 1989, the Senate held a series of daylong public hearings about the oil theft and other problems on Indian reservations, in Washington, D.C. The issue of oil theft was the subject of one hearing, and that hearing focused exclusively on Koch Industries. The committee asked Charles Koch, CEO of the company, to testify, but he refused. When the Senate released its final report, it stated declaratively: "Koch Oil ('Koch'), a subsidiary of Koch Industries and the largest purchaser of Indian oil in the country, is the most dramatic example of an oil company stealing by deliberate mismeasurement and fraudulent reporting."

When the Senate hearings were complete, Ken Ballen and his team boxed up their evidence and sent it to the U.S. Attorney's office in Oklahoma City. Elroy was assigned to the case, and later said he aimed to put Charles Koch himself behind bars.

Faced with the direst legal threat of his life, Charles Koch sprang into action. He was a wealthy industrialist from Wichita, Kansas who took control of his family's company in 1967 at the age of 32, when his father died of a heart attack. By the late 1980s, he had co-founded the Cato Institute, supported a smaller, obscure group called Institute for Humane Studies, and was generally interested in spreading free-market philosophy. But he avoided taking a major role in U.S. politics beyond making a few campaign donations to favored candidates.

Charles Koch believed that government was basically dysfunctional, and that any government program, no matter how well intentioned, did more harm than good. He disdained the idea of employing a team of lobbyists in the nation's capital because he saw lobbying as a betrayal of free market principles. He may have funded libertarian think tanks and free-market academic programs, but he believed that he could avoid the down-and-dirty business of engaging daily with Washington, D.C.

The Senate Investigation taught Charles Koch otherwise. Koch Industries claimed, in a written response to the Senate, that it was scapegoated by the investigation because the company was "politically unimportant," and made an easy target. Charles Koch would ensure that Koch Industries was never "politically unimportant" again.

When he went to build a political influence machine, Charles Koch didn't draw on conventional political wisdom. Instead, he drew on Koch Industries' corporate playbook. The company specialized in mastering complex systems. It ran pipeline networks, oil refineries and commodities trading desks that operated in opaque markets. The key to success was knowing more than your competitors and operating in way that didn't publicly expose your trading strategies to the outside world. Koch's political network mimicked this philosophy. Rather than simply hire lawyers and lobbyists, Koch used a network of front groups, training centers, and political operatives to combat the legal threat.

In 1989, the newly built Koch network was focused on one tactical goal—derailing the criminal investigation into Koch's oil gathering operations.

Three decades later, the impact of the Koch network in politics has been enormous. It stoked the fire of anti-government animus that remade U.S. politics in the '90s and 2000s. It played a vital role in derailing the last best chance to regulate greenhouse gas emissions in 2010. Wal-Mart, General Electric and Boeing might all have lobbyists, but only Charles Koch has one of the biggest lobbying offices in America, combined with a grassroots army called Americans for Prosperity, that can knock on doors and send volunteers to town hall meetings; combined with a constellation of think tanks that can generate and amplify talking points; combined with a network of coordinated campaign donors that often raise enough money for an election cycle to rival the war chest of a political party. Even in the age of Trump, when the Kochs' political influence is far smaller than it was earlier this decade, they still flex considerable muscle behind the scenes. In 2017, the network transformed the Republican tax plan by leading the charge to kill a tax benefit meant to benefit U.S. manufacturing (but that almost certainly would have hurt Koch's oil refining operations) and turned it into a straightforward tax cut for big corporations and the richest Americans.

But before all of that—before Charles and David Koch became household names, at least in liberal households—they deployed a then-developing political network against a U.S. Senate investigation. And they brought the lessons they learned with them to all of their lobbying and influence work over the next 30 years.

When the U.S. Senate sent its investigation on to the U.S. attorney's office in Oklahoma, the case landed on the desk of a federal prosecutor named Nancy S. Jones. She was a tough-minded woman from Independence, Missouri, with many years of experience investigating fraud: first for the New York state attorney general's office and then for the U.S. attorney's office in the Northern District of New York.

Jones took over the case after getting a call from Agent Jim Elroy. She didn't know the FBI agent very well but was receptive when he told her that he had one hell of a case involving theft and corporate fraud.

Jones empaneled a federal grand jury, which operated in secret to obtain evidence of any high-level conspiracy at Koch to steal oil. The grand jury investigated Koch Industries for many months. Jones wanted to know just how high up the chain of command at Koch Industries the culpability went.

By 1990, Jones was convinced that criminal wrongdoing was underway at Koch Industries. And she believed the theft might have been ordered from high levels in the company. Even at this early stage, Jones felt she had enough evidence to safely charge multiple low-level Koch Oil gaugers with theft. She believed there was also enough evidence to charge a group of higher-level managers with directing the criminal behavior. Jones and Elroy continued their investigation, however, because they wanted to push even higher up the chain of command at the company, maybe all the way to the executive suite. “There was too much at stake in the case, to settle for the underlings,” Jones recalled.

Koch’s first tactical goal was to change the political landscape around the issue of oil theft. In its final report on oil theft, the U.S. Senate had categorically accused Koch Industries of systematic theft. Koch needed to undermine that claim if it wanted to forestall future investigations and litigation.

A former Koch Industries employee named Ron Howell helped lead Charles Koch’s efforts to combat the investigation through politics. Howell was the ideal employee to spearhead Koch’s political reformation effort in Oklahoma. During his tenure at Koch, Howell had specialized in commodity trading. He knew how to work in murky networks and connect the needs of several parties in ways that could ultimately benefit Koch. He was well suited for operating in the world of politics.

After he left Koch Industries’ trading desk, Howell had become well-connected in Oklahoma politics. He remained a true believer in Koch Industries and was appalled when he heard that the company was accused of stealing oil from Indians. He was convinced the allegations were entirely false. He happily accepted the job to offer to join Koch’s political network and help burnish the company’s image.

“I’d been in the boardroom many, many, many times for many, many years,” Howell said later in an interview. “It’s just a very, very honorable company ... So I got angry as much as anything else.”

Howell’s first job was to reshape the political narrative about Koch Industries in Oklahoma. His strategy was to reach the producers themselves, meaning the oil drillers who sold crude to Koch Industries. The Native American tribes who owned the oil well leases were the most important target. The tribes were the most visible victims of the theft, and they were also the most sympathetic. If the Indian tribes could be brought on board with Koch Industries, it would undermine the entire rationale for a criminal inquiry into the company’s measuring tactics. If there were no victims, then how could there be a crime?

One of the primary victims of Koch Industries’ alleged theft was the Osage tribe in Oklahoma. Charles O. Tillman, chief of the Osage tribe, said that a team of employees from Koch Industries came to talk to him about the oil theft allegations after the U.S. Senate released its report. Koch sent a team of auditors to review receipts from oil leases owned by the Osage tribe. These receipts were compared against Koch’s internal figures to determine if Koch had indeed been underpaying the Osage, as alleged by the U.S. Senate. Tillman said the tribe had little capacity to double-check Koch’s work. The tribe didn’t have an army of accountants at its disposal. The tribal members simply got checks in the mail for their oil leases and trusted the numbers.

“Koch was such a gigantic company,” Tillman said. “To me, they were doing good accounting.”

When Koch Industries completed its audit, the company returned to Tillman with surprising news: Koch Industries had not been stealing oil. In fact, the company found that it been over-paying the tribe. The audit showed that the tribe actually owed Koch Industries about \$22,000. Koch's interpretation was backed up by federal authorities at the Bureau of Indian Affairs, Tillman said. He didn't feel like the tribe could question it.

Tillman and other Osage leaders went public with their belief that Koch Industries had not stolen oil from them. In March of 1990 the local Osage newspaper, the *Osage Nation News*, published a story in which the Osage chiefs said the company was innocent. The story was quoted in the mainstream *Daily Oklahoman* newspaper, and Koch Industries made maximum use of the chiefs' statements. Cordes, the company's top attorney, told the *Daily Oklahoman* that the Osage statement "completely undermines the false allegations of the Senate subcommittee."

Charles Tillman would later regret his role in tamping down concerns over the company's practices. His mind was changed after he learned about testimony unearthed years later in federal lawsuits. He became convinced that Koch Industries had, in fact, stolen oil from Indian wells. "We were wrong," Tillman said. "We were badly informed."

Dudley Whitehorn, another Osage chief who worked with Tillman, said in an interview years later that he also had become disillusioned. Whitehorn recalled that several years after the *Daily Oklahoman* article appeared, he was sitting in a local auto shop waiting for his car to be repaired. He said that a former Koch Industries employee sat down next to him and struck up a conversation. Whitehorn said the employee eventually told him: "We did steal from you." The man seemed contrite. Whitehorn didn't dwell on it. He didn't want to carry a grudge against the company. (Koch Industries was presented in February with Whitehorn's recollections and did not comment on them).

The Osage chiefs might have felt duped later on, but their public comments in the early 1990s achieved an important goal. The government suddenly looked overzealous and unfair. This fed into Koch Industries' broader efforts. While Howell was reshaping the story in Oklahoma, the company was working to do the same thing in Washington, D.C.

Koch Industries deepened its relationship with Kansas Sen. Bob Dole. The Kochs already contributed to his campaigns and political causes, giving \$245,000 between 1979 to 1994, according to an analysis by the Center for Public Integrity. David Koch, Charles' brother and a major shareholder in Koch Industries, would abandon the Libertarian Party to become the vice chairman of Dole's presidential campaign against incumbent Bill Clinton in 1996. By that time, the family would become Dole's third-largest financial supporter, according to an investigation later published in *Businessweek* magazine.

Dole helped Koch Industries delegitimize the issue of oil theft. Dole submitted the story from the *Daily Oklahoman* into the Senate record and said that he was concerned that the Senate had rushed to judgment to condemn the company. Koch Industries amplified his concerns with the help of other senators, including Don Nickles from Oklahoma. (During an interview in 2016, Sen. Dole had a hard time recalling details about his relationship with Koch Industries.)

As senators fought against the findings of their own committee, Koch Industries put another piece of its plan into place. The biggest threat wasn't emanating from the Senate but from the courts and the U.S. attorney's office, two institutions that could not be influenced by campaign

donations or lobbyists. In response, Koch's political network initiated a long-term plan to reshape America's judiciary system.

Ron Howell founded an obscure nonprofit group called Oklahomans for Judicial Excellence. It did something unheard of: It started grading local judges based on their fealty to free-market economic theory. The group created scorecards for state judges, measuring how well their verdicts conformed with the teachings of Friedrich Hayek and Ludwig von Mises. The group publicized these rankings with public opinion articles published in places like the *Daily Oklahoman*. The grading system created a way to embarrass judges in the local press by publicizing their low scores. Koch's political network also offered them a way to escape this embarrassment: The company sponsored a series of free seminars that judges could attend if they received poor grades from the company's rating system. The seminars were not held in stuffy classrooms. The Koch network paid for judges to travel to a ski resort in Utah or a beachfront condominium, among other locations, relaxing places where the judges might be more open to the company's message. The company held lectures that emphasized the importance of market forces in society and warned against the consideration of things like "junk science" that plaintiffs often used to prove corporate malfeasance. The seminars were well attended, sometimes by more than 60 judges at a time, according to an account later published in the *Wall Street Journal*.

Koch networks' efforts to sway judges evolved over many years. By 2016, it had transformed into a new program that offered free seminars to judges called the Law & Economics Center, which was housed at George Mason University in Fairfax, Virginia, along with the Koch family-funded free-market think tank, the Mercatus Center. The Law & Economics Center claimed to have hosted more than 4,000 state and federal judges from all 50 states at its seminars. It offered up to a dozen events a year. Over decades, such programs have helped fill the judiciary with judges more sympathetic to Koch's free-market views.

This long-term effort did little to solve the company's immediate threat from Nancy Jones' investigation. She and Jim Elroy were making strides in the case. They believed they were close to proving that Koch Industries' oil theft was directed from the highest levels.

Then they hit a wall.

Jones and Elroy had zeroed in on one particular set of Koch Industries' internal documents they felt would show how the oil theft was directed from the company's senior leadership. They had subpoenaed those documents and were waiting for Koch Industries to supply them to the grand jury. Then Nancy Jones got a letter from the company's lawyer. Those documents had been accidentally destroyed, the letter said.

This was puzzling to Elroy. He knew that Koch Industries kept backup copies of its corporate documents in an underground storage area; the kind of place where company papers were treated carefully. Koch Industries insisted to Jones that the documents in question had not been converted into digital files, as had many other corporate documents. "There was no reason why those records shouldn't still exist. But when the grand jury wanted them, then they were not available," Jones recalled. She couldn't describe the documents due to the rules of grand jury secrecy.

Jones and Elroy discussed how to move forward with the case. Then something happened that arguably killed the investigation. Jim Elroy quit. He said it was for personal reasons. The FBI offered him a transfer to the Miami office and, a California boy, Elroy had a strong desire to return to the ocean. Decades later, Elroy would regret the decision. “It was really selfish. I should have stayed and finished this job,” he said. “I know if I had stayed, that Charles and David would be in jail now.”

In Elroy’s absence, however, the investigation took a sharp turn in Koch Industries’ favor. There was a growing body of evidence that the company might be innocent.

In the summer of 1990, the FBI interviewed dozens of Koch oil gaugers throughout Oklahoma and Texas. The gaugers all said essentially the same thing: Koch had never instructed them to steal, they had never heard of the “Koch method”—**a method for stealing oil in which** gaugers intentionally misreported the amount and quality of oil they collected at well sites — and they never falsified their measurements. The gaugers said this even when they were alone with their FBI interrogators—one gauger was interviewed in a Dairy Queen parking lot. The litany of interviews undermined the case.

Just as the interviews were clouding the picture, there was a management shakeup at the U.S. attorney’s office. Nancy Jones’s boss, U.S. Attorney Bill Price, quit his job to run for higher office.

Price’s replacement would be selected by Oklahoma senator Don Nickles, a close ally of Koch Industries. Nickles had previously spoken about the case with Koch Industries’ lobbyist Ron Howell, who remembered pulling Nickles aside at a luncheon to discuss the case. Nickles would later leave office and open a lobbying shop in Washington, D.C., where Koch Industries was one of his clients.

In 1989, Nickles chose a politician and lawyer named Timothy Leonard to fill the U.S. attorney’s job. Jones quickly developed her own opinion about Leonard. She considered him to be a “political hack.” Leonard was aware of her opinion, and the two of them never had an easy relationship.

Jones ended up quitting her job. Like Elroy, she said it was primary for personal reasons. She was tired of living in Oklahoma City, and didn’t like working for Leonard. It would be up to Leonard to determine how to pursue the case.

In April of 1991, as the Koch case was still moving forward, Nickles nominated Timothy Leonard to become a federal judge. In November, President George H. W. Bush confirmed Leonard’s appointment. Less than four months later, while he was still U.S. attorney, Leonard dropped the case against Koch Industries and his office sent a letter to the company saying that it would not be indicted. Leonard did not explain publicly why the case was dropped, even though Jones said that the grand jury had obtained evidence showing criminal conduct of Koch Industries employees and managers. Whatever evidence Jones obtained could never be made public because of secrecy rules that govern grand juries.

Did Koch’s influence get the investigation killed? It looked that way from the outside, but there’s reason to believe it wasn’t that simple.

The company had obviously deployed its lobbyists and think tanks to influence public figures in Oklahoma, and the trail of influence between Koch Industries, Nickles, and Judge Leonard

seemed straightforward: The company's political ally Nickles appointed Leonard to the U.S. attorney's office, then Nickles nominated Leonard to the federal bench and Leonard decided to drop the charges. It seemed to Koch Industries' critics like Leonard might have been rewarded for dropping the charges.

There is no evidence, however, to support this claim and there is strong evidence to refute it. The FBI's case file in Oklahoma, released in 2018, shows that there was plenty of reason not to file charges. Dozens of FBI interviews with gaugers failed to corroborate the accusations against the company. Internal FBI memos also show that it was Assistant U.S. Attorney H. Lee Schmidt, not Leonard, who recommended that the case be dropped. (Schmidt declined to comment on the case.)

It seems that the dozens of FBI interviews convinced Schmidt there simply wasn't enough evidence to file charges. The FBI files did not show what evidence Jones obtained from the secret grand jury proceedings, but Leonard later said that Jones never told him or anyone in his office that there was enough evidence to file charges against Koch managers before she left.

There is also evidence to suggest that Leonard actually fought to protect the investigation from political interference. Leonard said that shortly after he arrived, the FBI briefed him about the U.S. Senate investigation into Koch and the political controversies it had ignited. In late 1989, Leonard sent a letter to the FBI in response, chastising the agency for sending him statements about the Koch case made by U.S. senators in Kansas and Oklahoma. "Your presentation of this letter to this office both puzzles and concerns me," Leonard wrote. He went on to say that the investigation was independent, and that the "view of any elected official" regarding the Senate investigation of Koch would "have no bearing on the course of the grand jury investigation."

When pressed on the issue during our interview at his home, Leonard walked into another room and retrieved a weathered copy of the Bible that he said belonged to his grandfather, a Presbyterian minister. Placing his hand on the book, Leonard said: "I never had any contact with Senator Nickles, or any other political person, and there was no political thought or influence that ever entered the US Attorney's decision" on the Koch Oil case or any case.

While there is no evidence that Leonard dropped the charges inappropriately, new evidence later emerged that Koch employees had indeed stolen oil, even if FBI agents in Oklahoma and Texas failed to prove it.

This new evidence was revealed thanks to the efforts of Bill Koch, Charles and David's estranged brother who waged a legal fight against them for years after he failed to take control of the family company and was pushed out in the 1980s.

After Leonard dropped the case in 1992, Bill Koch bankrolled a massive civil suit against Koch Industries, filed in federal court, using an obscure law that lets citizens file lawsuits on behalf of the U.S. government. Bill Koch was essentially acting as a whistle-blower. He happily told journalists that the suit was just another weapon in his arsenal to attack his older brother Charles, and Bill spared no expense in making that weapon as dangerous as possible. He had tracked down Jim Elroy and hired him to investigate Koch's oil gathering business around the country. Elroy spent months combing small towns in rural America, visiting oil gaugers in their homes

and collecting their stories. Bill Koch's interviews were more successful than the FBI's in digging up damning testimony.

The case went to trial in Tulsa in late 1999. The testimony was devastating for Koch Industries. During the trial, Koch officials admitted that they earned roughly \$10 million in profits each year by taking oil without paying for it. Witness after witness described the Koch method of stealing oil. Jack Crossen, a district gauger for Koch in Oklahoma, described under oath how the company trained him to intentionally mismeasure oil. Phil Dubose, a former senior manager at Koch, testified that Koch Industries' business strategy relied on theft. Tales of theft were told by Koch's own employees from Kansas, Texas, Oklahoma, North Dakota and New Mexico. A gauger named Ricky Fisher said he rationalized stealing oil just so he could keep his job. "You're programmed to think and believe you take a little from this man, and it won't hurt him," Fisher said from the witness stand.

The jury found Koch Industries guilty of stealing oil between 1981 and 1985 from federal land and Indian reservations, and of falsifying roughly 25,000 documents in order to underreport how much oil the company was taking.

The fines for Koch Industries could have been enormous. The judge could have levied a \$214 million fine just for falsifying the oil sale receipts. But the company's lawyers were able to settle the case before it went to the penalty phase, paying an undisclosed amount.

The oil theft case ended there. But the political apparatus Koch built to fight it only continued to grow. The pieces put into place in the early 1990s—the third-party front groups like Oklahomans for Judicial Excellence, the massive campaign contributions, the media outreach, the direct corporate lobbying—all of it would be used to fight Koch's primary adversary: the federal government.