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Koch brothers vs. Cato: Cato Chairman Bob Levy refutes Charles Koch's statement

By Allen McDuffee
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Last Thursday, Charles Koch released his full statement regarding the lawsuit he and his brother, David, filed last month for control of the Cato Institute.

Today, Cato Institute Chairman Bob Levy responded to Koch's statement point-by-point, characterizing it as doing "nothing to address the genuine concerns expressed by their friends and ours that the action the Kochs have taken will pointlessly and grievously injure the movement for individual liberty that they have previously done so much to advance."

The full Levy response below the jump:

On March 1, after filing suit in Kansas court to gain control over the Cato Institute, Charles Koch issued a statement to the media: "We are not acting in a partisan manner, we seek no 'takeover' and this is not a hostile action." The purpose of the suit, he insisted, was simply "to ensure that Cato stays true to its fundamental principles."

Last week, Mr. Koch circulated a longer "Statement Regarding the Cato Institute," again professing his "steadfast intent" that Cato remain "a principled and nonpartisan organization that would advance the ideas that enable all people to prosper – by promoting individual liberty, limited government, free markets and peace."

But actions speak louder than words. The Kochs' takeover attempt has included packing Cato's board of directors with individuals, almost all of whom are financially entangled with the Kochs and have no history of libertarian advocacy.

Moreover, their latest statement does nothing to address the genuine concerns expressed by their friends and ours that the action the Kochs have taken will pointlessly and grievously injure the movement for individual liberty that they have previously done so much to advance.

It should have been obvious to Charles Koch that filing this suit would necessarily result in a public battle that would threaten the Cato Institute's credibility – wounding allied organizations and scholars in the process. You be the judge. Imagine that Charles Koch prevails in his lawsuit against Cato, and that he and his brother then "own" two-thirds of Cato's stock. Would an Institute whose board of directors is appointed by the Kochs be viewed as a credible source of nonpartisan, nonaligned, independent commentary on vital public policy questions? Or would the think tank now known as Cato cease to exist because its 35-year unimpeachable reputation is critically damaged by the (unfortunately accurate) perception that Cato is literally "owned by the Kochs"?

In his latest message, Mr. Koch relates "the facts behind what we have done and why." I regret to report that his facts are at best incomplete and accompanied by a host of misleading assertions. What follows are the Cato Institute's responses to the central points Charles Koch raises.

Koch: "My brother David and I have every intent to ensure Cato continues its work on the full spectrum of libertarian issues for which it has become known."

Recent actions by the Kochs elicit doubts about that proclamation. If the Kochs seek to ensure that Cato stays true to its fundamental libertarian principles, why would nearly all of their nominees to Cato's board be Koch employees, consultants, and outside counsel who have never supported the Institute, never attended its events, never been interested in its governance, and never distinguished themselves as advocates for libertarianism? Indeed, why did the Kochs appoint Koch Foundation vice president Kevin Gentry, a prominent official with the Virginia Republican Party, or Koch Industries spokesperson Nancy Pfotenhauer, who served with the McCain campaign and has defended, among other things, the military's "don't-ask-don't tell" policy and the war in Iraq? Why did the Kochs nominate Tony Woodlief, who has described libertarianism as "a flawed and failed religion posing as a philosophy of governance"? Woodlief seems to like libertarians (and vice versa), but he's nonetheless written that "libertarians sound like absolute fools when they talk about foreign policy." Why did the Kochs nominate John Hinderaker, who sometimes describes himself as a neocon and believes "the original Patriot Act was entirely reasonable"?

Is that how the Kochs would ensure that Cato "continues its work on the full spectrum of libertarian issues"? What is it that Cato has done to convince Charles Koch that Cato's work on libertarian issues needs help from directors who are demonstrably not libertarians and would never have been nominated by Cato's then-current board?

Koch: "We proposed a standstill agreement to delay for one year or longer any discussion on the shareholders agreement."

Yes, the Kochs proposed a standstill agreement that Cato rejected because the status quo could not be maintained. Too many key people had learned of the looming problem. Several of Cato's largest donors had announced they would discontinue their donations until it became clear that the Kochs would not control Cato. A number of Cato benefactors said they would change their wills to eliminate Cato as a beneficiary if Koch dominance was an ongoing threat. Essential employees had expressed their intent to leave Cato unless the governance issue could be resolved in a timely manner. Cato's search for professional talent, including most particularly a successor to president Ed Crane, was frustrated by the obligation to disclose the impending shareholder conflict.

The purpose of the Kochs' disingenuous standstill proposal – confirmed in a meeting with me – was to "get past the election," after which the Kochs would be less anxious about alienating the army of Cato's libertarian loyalists. Put bluntly, a standstill would have jeopardized Cato's day-to-day operations while resolving nothing.

Koch: “We asked to delay any shareholders meeting, which would have left the pre-March 1 board of directors in place during this period.”

The Institute’s bylaws require an annual meeting of shareholders on the first business day of December. The shareholders unanimously agreed to postpone the meeting for a “reasonable period” to try to resolve the dispute over Cato’s governance. After 90 days, during which the Kochs rejected a Cato proposal that addressed all their professed concerns (see more below), the meeting was rescheduled for March 1. Further delay would have been equivalent to the Kochs’ standstill proposal, which they knew Cato could not accept.

To set the record straight, the shareholders meeting did not precipitate anything. It simply satisfied a legal requirement and, in the end, allowed the Kochs to add four directors to Cato’s board. Cato and the Kochs could have continued their attempt to negotiate a settlement, reserving the right to take legal action should the negotiations prove fruitless. But one day before the meeting, the Kochs filed a lawsuit in Kansas (accompanied by a “Politico Exclusive”) that exposed this dispute to intense scrutiny. It should have been obvious to the Kochs that filing the lawsuit would generate a public battle that would – no matter which party prevailed – harm the entire libertarian movement.

Koch: “We proposed third-party mediation ... and alternative corporate structures.”

More specifically, the Kochs proposed non-binding mediation – merely a timing tactic that would have meant protracted and unproductive talks between Cato and Koch representatives instructed to “get past the election” and otherwise make no concessions. As for alternative structures, the Kochs proposed two eight-person boards, one selected by them and one selected by Cato’s current board. After their initial selection, the two boards would function as one, but each of the two components would elect their own successors. In other words, the Kochs wanted to control not the three board seats they held at the time, but eight seats – an outcome even less acceptable to Cato than the standstill that had already been rejected. For more than a decade, Ed Crane had tried to persuade the Kochs to restructure the Institute’s governance, thereby removing the threat to Cato’s autonomy that 50 percent Koch control entailed. The Kochs’ “alternative” was another version of the same unsustainable 50/50 scheme.

The only real alternative was proposed by Cato: Abandon the shareholder structure and implement a member-elected board with the directors themselves serving as members – a governance arrangement favored by the Internal Revenue Service and practiced by most nonprofits (including Cato for more than 30 years). In return, the Kochs would be assured that their key stated objective – preserving original donor intent – would be satisfied. Charles and David Koch would have veto power over any material change in the Institute’s mission, sale of the Institute’s assets, merger, or other combination. Moreover, Ed Crane agreed to an immediate search for his successor; and the Kochs would have veto power over the person selected.

Revealingly, Crane’s offer to leave wasn’t enough for the Kochs; they demanded control of the Institute’s board in addition to its president. That point bears emphasizing: However much it might serve the Kochs’ interests to portray this dispute as a personality clash between two men, the facts do not support that narrative. In a bid to save the Institute and its mission, Ed Crane offered to retire in an expedited fashion in exchange for undoing the shareholder arrangement. Although Cato rejected the Kochs’ untenable demand that Crane's successor be installed within eight weeks, this fight has never been about Crane's position at Cato. It has always been about the efficacy of the Institute as an independent advocate for personal freedom and limited government.

Koch: "Every counterproposal we received required we forfeit our shareholder rights. ... [A] new shareholder was to be recognized in violation of our long-standing written agreement and the Institute's bylaws and articles of incorporation."

The threshold legal question in the lawsuit filed by the Kochs against Cato and its other two shareholders is how to interpret the murky provisions of an agreement signed more than three decades ago. The Kochs portray this dispute as a denial of their property rights. They ask how libertarians could fail to honor contractual commitments – as if the existence of the contract requires Cato to embrace Charles Koch's interpretation of its terms.

Prior to the October 2011 death of Cato's former chairman, William Niskanen, the Kochs controlled 50 percent of Cato's stock. Today, the Kochs claim they control 67 percent because Niskanen's shares must either be purchased by Cato or by its remaining shareholders. But the agreement signed by the shareholders provides that Cato may elect not to purchase the shares. Furthermore, the shares need not be offered to the other shareholders unless Cato's board deems that a purchase by Cato would have been "inconsistent with its corporate purposes." Otherwise, the shares can be transferred to Niskanen's widow, Kathryn Washburn, in accordance with his last will and testament. Recognition of Ms. Washburn as a "new shareholder" would be wholly consistent with Cato's bylaws and articles.

Cato's position is correct: The Kochs control 50 but not 67 percent of the stock. Ultimately, however, the courts will resolve that issue. It is not the crucial issue. Rather, the crucial question is whether Cato can survive if its donors, employees, and the public policy community perceive that the Kochs have elected a pivotal number of the Institute's directors – whether 50 percent or 67 percent – who would be responsive to Koch political and corporate demands.

Koch: "We want to ensure Cato remains consistent with the principles upon which it was founded."

The best way to ensure Cato's consistency with libertarian principles is to restore board, not shareholder, governance. Organizations such as the Ford and MacArthur foundations were led astray when apostate directors took control over large endowments. Significantly, Cato is not endowed and must raise all of its operating funds on an annual basis. Charles Koch provided seed money, but not an endowment that directors could expropriate.

As long as Cato's board was self-perpetuating, it stayed rigorously on its libertarian course. Only now, with directors chosen by four shareholders in or approaching their 70s, who have uncertain mortalities and differing governance perspectives, has the course of the Institute become volatile and unpredictable. That's proven by recent board elections, in which Charles and David Koch replaced committed libertarians with acknowledged non-libertarians. Those changes have not been "consistent with the principles upon which [Cato] was founded." Who knows what could transpire when the remaining shareholders pass on?

The Kochs have repeatedly cast this dispute, not as a battle for control, but an effort to guard against ideological drift and preserve "donor intent." In an email message sent by the Koch Foundation to its alumni network, recipients were told that Charles and David Koch, "as active donors contributing tens of millions to Cato ... feel the shareholder structure is important to preserve donor intent."

Original donor intent is one factor to be recognized. But over the past 35 years, the Kochs have provided roughly nine percent of the Institute's cumulative budget. More recently, it's been four percent. Currently, it's zero percent. The Cato directors replaced by Koch nominees have contributed nearly as much as Charles and David Koch and their allied foundations combined. Yet Charles Koch insists that the original donor's intent is all that matters. What about the intent of the donors who now fund 100 percent of Cato's operations?

In a normal business environment, with no endowment and ongoing capital requirements, the founders' ownership position would be significantly diluted unless they continued to provide all of the funding. In this instance, not only do the Kochs not provide all of the funding, they do not provide any of the funding. The Kochs, who believe in market-oriented principles, would never finance a for-profit organization that gives total control to a few original donors who now contribute nothing and no control to current donors who now contribute everything.

Koch: "There is a great deal of speculation as to what direction we would take Cato if we were to be in a position to elect a majority of the board."

Perhaps there is "a great deal of speculation," but there need not be. David Koch and chief Koch lieutenant Rich Fink expressly announced their intentions at a meeting with me in November. The Kochs want Cato's work to be more closely coordinated with Koch-allied groups such as Americans for Prosperity, a 501(c)(4) grassroots activist organization committed to free markets and limited government. Cato would become the source of "intellectual ammunition" for AFP – through position papers, a media presence, and speakers on hot-button issues. That might strike some libertarians as puzzling. After all, AFP already has a sister 501(c)(3) organization, the AFP Foundation. And Koch financial resources, which have not been directed toward Cato, are surely available to generate the intellectual ammunition that AFP wants – without compromising the integrity of the Cato Institute, which cannot take its marching orders from the Kochs or any of their affiliates.

Equally puzzling, Cato and AFP both declare their devotion to free markets and limited government. Why, then, would Cato's current efforts not yield the kind of intellectual ammunition that could be used by AFP and others? When I asked David Koch and Rich Fink that question explicitly, they had no direct answer. The clear implication was, they wanted to be in the driver's seat – not just with respect to Cato's philosophic base, with which the Kochs had no disagreement, but also with respect to issue choice, timing, and even geographic focus. Of course, that is precisely the sort of coordination and direction that would gravely undermine Cato's independence and decimate the Institute in its role as a source of intellectual ammunition for the public policy community at large.

Koch: "These officers and board members would act independently from me."

Again, that's an assertion we are supposed to take on faith. But Koch-backed appointees to Cato's board now include the three largest shareholders of Koch Industries, a vice president at the Charles Koch Foundation, an authorized spokesperson for Koch Industries, and a distinguished Republican lawyer who represents and publicly speaks for Koch Industries.

Moreover, it is necessary but not sufficient for officers and board members to act independently of whoever controls an organization such as Cato. Just as important, the officers and board members must be viewed by outsiders as separate, scrupulously autonomous, and self-governing. Because of the Kochs' vast corporate interests and their well-publicized engagement in electoral politics, Cato simply cannot be viewed as free of Koch influence if the Kochs elect the board of directors.

The Kochs point to the Mercatus Center and its sister organization, the Institute for Humane Studies, as examples of 501(c)(3) entities untainted by their close connection to Charles Koch, David Koch, and Rich Fink. But Mercatus is not Cato. It's a university-based academic research center, led by a faculty director appointed by the provost of George Mason University, staffed primarily by GMU scholars, focused on domestic economic and regulatory issues, and, accordingly, much better insulated from outside control than Cato would be under the arrangement that the Kochs seek to implement. Moreover, Cato's agenda is far broader than Mercatus's, comprising not only domestic economic policy, but also foreign affairs, national defense, social issues, global freedom, constitutional questions, civil liberties, criminal justice, libertarian theory, and other areas. Similarly, the Institute for Humane Studies, which also operates under a George Mason University umbrella, is devoted to the development of talented and productive students and scholars. While IHS shares Cato's commitment to liberty, it is not immersed in ongoing public policy debates. And neither IHS nor Mercatus has shareholders who elect the organization's board of directors.

Koch: "With its emphasis on education, Cato has contributed greatly to the marketplace of ideas and is now a respected thought leader."

We couldn't agree more. The testimonials to Cato's effectiveness from independent parties on the political Left, Right, and Center who have followed the Koch lawsuit affirm Charles Koch's public acknowledgment of our success. But why, then, have the Kochs insisted on precipitously replacing Cato president Ed Crane and ousting key members of the Institute's board of directors who have contributed to that success? What is the rationale for a new leadership team and a new direction for our institute? We have repeatedly asked the Kochs and their representatives those very questions and have never received a straightforward answer, in private or in public.

Here is the bottom line: Cato cannot function as an independent voice for liberty if it is thought to be under the thumb of Charles Koch or Rich Fink – indeed, literally owned by the Koch family. Nor, if the lawsuit succeeds, will Cato be considered a reputable and credible source of "intellectual ammunition" by anyone outside the small circle of already committed libertarians. Instead, the Kochs will control a shell think-tank that can be dismissed out of hand as a front for Koch Industries. That's the clear consensus of nearly everyone who has seen this lamentable and unwelcome dispute unfold.

Nothing good can come of this – not for Cato, not for the Kochs, and not for the libertarian movement. It's time to restore common sense and adopt a governance structure for Cato that eliminates the prospect of Koch control.