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One False Move

For years, investing legend DAVID BONDERMAN could do no wrong. And then he tried to buy a utility from Enron.

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(FORTUNE Magazine) – THEY'RE THE KINGS of American business these days. Private equity firms, hedge funds, and their cash-laden ilk have been pulling the levers of capitalism, with investors you've never heard of amassing billions and buying corporate icons like Sears.

Among this extremely quiet species, David Bonderman is as dominant as they come. He has earned a reputation as a master dealmaker, a tornado of a man spinning equal parts brilliance, energy, and charm inside his ever-moving vortex. His private equity partnership, Texas Pacific Group, has massive throw-weight. The firm says it has $20 billion under management--a gaudy sum that includes a series of under-the-radar Texas Pacific affiliates in the U.S. and Asia. That war chest puts the firm in the top tier of buyout funds and dwarfs those of raiders like Carl Icahn or even hedge fund upstarts like Eddie Lampert. Just in the U.S., Texas Pacific controls companies with annual revenues of $35 billion. If it were a public company, it would rank at No. 51 on the FORTUNE 500, somewhere between Motorola and Lockheed Martin.

Like any private equity firm, Texas Pacific, which is based in Fort Worth and San Francisco, gathers cash from pension funds and wealthy investors and uses it to buy control of companies. What sets it apart from its peers is its reputation for taking on risky, unfixable companies--and then devoting serious resources to fixing them. A dozen of Texas Pacific's 57 professionals are devoted to the nitty-gritty of operating the companies the firm buys. The game here is Extreme Makeover: Corporate Edition. Bonderman buys a company, brings in a Texas Pacific SWAT team to renovate and spruce it up, and then sells it for huge profits. His team's buyouts have included Continental and America West airlines, Oxford Health, Del Monte Foods, PETCO, and J. Crew, to name a few.

Bonderman's high-profile deals have given him a mystique. He's the man who can close the sale, and his secretive style only feeds his aura. People may not see how he does it,but they see the results. The stealth isn't just a matter of personal preference. Bonderman has learned it's much easier to conduct business far from the prying eyes of the media, stock analysts, and the public. (Indeed, Bonderman declined to be interviewed for this article. Texas Pacific co-founder Jim Coulter and partner Kelvin Davis gave interviews on the condition that they not be quoted.)

That's why it was so remarkable to see Bonderman last spring in the cramped offices of the Citizens' Utility Board of Oregon, a consumer-advocacy group in Portland. The master dealmaker was trying to persuade the advocacy group's bearded executive director and its less rumpled staff attorney to support his proposal to buy the local utility, Portland General Electric. Unfolding his lanky frame inside a conference room half-filled with moving boxes, Bonderman made his pitch but couldn't move the two men one iota. And even if the tone remained jocular, each side accused the other of cluelessness. "He thought we were naive about the utility business," says the Board's lawyer, Jason Eisdorfer. "And we thought he was naive about utility regulation."

It was just another queasy moment for Bonderman in a deal filled with them, one that was jammed with enough bizarre twists to fill a potboiler. Before it ended--and that end appears to have come on March 10--Texas Pacific's prosaic attempt to buy a utility sparked an epic series of reactions: public demonstrations, two conflict-of-interest investigations, state senate hearings, the leaking of "secret documents," and an underage-sex scandal. Texas Pacific saw its previously pristine reputation tarred and feathered, at least in Oregon, and linked to the dark name of Enron.

And it all played out on a public stage, providing a rare chance to view the world of private equity and see in action one of the most intriguing investors working today. Of course, the visible nature of it only heightens the embarrassment for Bonderman, especially given that it comes on the heels of another public episode that nicked his reputation: his tussle last year with Continental's then-CEO Gordon Bethune (see the fortune.com archive), in which Bonderman agreed to leave the company's board--but only if Bethune resigned too. In truth, Bonderman will need to trip up a few more times before his eminence is questioned. But in the world of private equity--where investors are locked into funds for a decade with only the vaguest knowledge of the investment strategy--reputation really matters. Mystique matters.

In the end, this is a saga in which Bonderman's many gifts--his intelligence and charm--couldn't stop a deal from spinning out of control. When the wizard was forced to step out from behind his curtain, it appears, his powers failed him.

IF YOU HAD TO SKETCH THE PATH TO becoming a buyout legend, it probably wouldn't resemble the winding turns of David Bonderman's life. And yet it's precisely his eclectic past--and present--that inform his unique way of thinking and let him see opportunities that others miss.

A former law professor, Bonderman speaks Arabic, studied Islamic law in Cairo, and was once a civil rights attorney at the Justice Department. He also won a big insider-trading case in the U.S. Supreme Court and played a key role in the bankruptcy proceedingsof Braniff International Airways. On the side, he led a successful landmark-preservation fight to save the Willard Hotel in Washington, D.C., and helped protect Grand Central Station in New York City.

Bonderman, say friends and colleagues, has always been razor-sharp and funny. He has a lawyer's love for the thrust and parry of intellectual engagement. But his nonconfrontational demeanor softens his comments, giving him an irreverent candor that he employs to advantage. Still, he can verge on glibness, as when he told the U.S. Supreme Court in 1983, in response to a question about his opponent's argument, "The problem with the SEC's theory is that it's wrong." The courtroom audience tittered--but the judges ultimately agreed with him.

It was in a landmarks-preservation battle in Fort Worth that Bonderman met the billionaire Robert Bass. In what appears to have been a stroke of genius, Bass hired the lawyer--whose nonlegal experience was limited to a little real estate investing on the side--as his own chief investor. For a decade, Bonderman thrived.

The restless investor decided to strike out on his own in the early 1990s on a deal that didn't strike Bass's fancy. The target: Continental Airlines, which was then in Chapter 11. Using his airline-bankruptcy experience, he masterminded the restructuring of Continental and brought in Gordon Bethune, who led a turnaround. From there Bonderman embarked on a series of buyouts. His firm developed a trademark style: Invest in distressed industries and build in mechanisms to reduce risk. Before putting cash into the then-disintegrating Oxford Health in 1998, the firm negotiated a provision that would let it reprice its investment after about a year so that Texas Pacific wouldn't be hurt if shares continued to drop before a turnaround was implemented. The strategy worked, and as the years passed, Bonderman and his partners began to build an institution. Today the firm has 14 partners in a wide range of specialties. But it's Bonderman who is the larger-than-life figure.

There are any number of traits that allow Bonderman to spot and exploit good opportunities. But the ability to quickly absorb and process information may be his greatest gift, according to friends and colleagues. Tom Barrack, who is both, spent a decade with Bonderman on Continental's board. He describes a typical scenario: "I would've spent endless hours reading arcane board books--thousands of quantitative metrics, hundreds of papers. And David would roll in from someplace at 6:30 in the morning on his airplane and come straight to the board meeting. And we'd just be starting the financial presentation. And he has that ability to go to page 117, footnote 6, and ask just that one question that the whole financial management group was hoping nobody would ask. And it sends the rest of the board into shock."

Bonderman manages to perform this trick on multiple deals, all more or less at the same time. David Stanton, a Bonderman admirer who used to be a partner at Texas Pacific, says he "is able to juggle five, six, seven balls at a time and has an appetite to try to juggle an eighth, a ninth, and a tenth."

That trait seems to apply to Bonderman's whole life. He's always grappling with multiple deals and moving, moving, moving. Rare is the week he doesn't go abroad. At the same time, he's calling and e-mailing incessantly. People who work with him say it's routine to get calls back within a few hours whether Bonderman is in San Francisco, Dublin, Seoul, or anywhere in between.

Pleasure-travel is part of the Bonderman blur too. He likes the occasional relaxing vacation. More characteristically, though, he'll organize a trip to some obscure corner of the earth and bring along as many friends as possible. Here's Bonderman leading a small convoy of Land Rovers on the Silk Road across Central Asia, using broken Urdu to chat with the locals. There he is in the Marquesas Islands in Polynesia, floating toward land to chat with the locals in French. There he is again in the hills of Papua New Guinea, somehow picking up a Pidgin English dialect and, yes, chatting with the locals.

Bonderman's manic whirl also encompasses his favorite cause: environmentalism. He has not only served on the boards at the World Wildlife Fund, the Wilderness Society, and the Grand Canyon Trust for a decade or more, but he has also poured an immense amount of energy into them. Bonderman has flown to Europe to negotiate a $1 million reduction on a lease for one of the Wilderness Society's offices. He has haggled with power plants in Arizona to reduce pollution that wafts over the Grand Canyon. "He's one of the country's greatest conservationists right now," says Charles Wilkinson, chairman of the Grand Canyon Trust.

But Bonderman is not without his paradoxes. He lives in a 14,000-square-foot, 11-bedroom house on 900 acres in an Aspen wildlife preserve and he jets around the world in a Gulfstream GV. (Actually, his "official residence" is in Fort Worth and his family stays in Aspen, but he might as well list his address as the GV.) Yet despite that, he thinks stretch limos are ostentatious. Bonderman has sent away limos when people dispatch them to pick him up at airports. It appears he literally doesn't want to be seen as a limousine liberal.

And don't confuse his aversion to the press with any hermit-like tendencies. For his 60th birthday, Bonderman invited hundreds of friends--ranging from high-end dealmakers to a Peace Corps volunteer he met in India--to a spectacular bash in Las Vegas. Robin Williams gave a roast, and John Mellencamp and the Rolling Stones provided the music. The next morning the guests were invited to brunch in a restaurant festooned with colorful socks, a nod to one of Bonderman's sartorial quirks.

BONDERMAN IS WELL BEYOND RICH AT age 62, but he still craves the adrenaline of challenging, complex acquisitions. It's what makes him tick. And that, perhaps, is what drew him to Portland General Electric. It started with the one-two punch of the Enron meltdown and the California energy crisis. Investors were fleeing the power sector; Texas Pacific decided it was time to enter. The firm put three people to work for more than a year researching the business and came up with an idea: to buy PGE from the bankrupt Enron.

It was the quintessential Texas Pacific deal. Two power companies had tried to buy PGE in the bankruptcy process. Both had failed, in part because of the massive Enron liabilities that could potentially attach themselves to PGE. But Texas Pacific thought it could pull it off. The firm negotiated an agreement in which Enron agreed to cover up to $1.4 billion in liabilities. And the price was right: Texas Pacific persuaded Enron to unload the utility for $1.25 billion (plus the assumption of $1.1 billion in debt), a third less than the company had paid six years earlier.

Once you stripped out the Enron liabilities, it was actually a low-risk deal. Like all power companies, PGE isn't glitzy, but it delivers steady earnings. The purchase price, says one analyst, was $500 million less than PGE is worth. So if Texas Pacific, which would put down $420 million in cash (along with $100 million from passive investors) and $700 million in debt, did nothing other than erase the taint of Enron, it could generate a 100% return.

But there was a catch: PGE is a regulated utility. A half-dozen different state and federal agencies would have to sign off. No problem, the Texas Pacific team thought. We've dealt with airline regulators, bank regulators, insurance regulators. Why should this be any different? Well, maybe it was the second catch: an Oregon law requiring that any utility sale result in a "net benefit" to customers. Texas Pacific was legally obligated to make the deal worthwhile for the utility's ratepayers.

The regulatory process in Oregon allows great latitude for a huge range of participants to become, in legalese, "intervenors." Ultimately the state's utility commission decides on the deal, but the intervenors are roughly equivalent to parties in a lawsuit: They get to examine Texas Pacific's documents and take depositions. Then they can negotiate a settlement, oppose the deal, or propose conditions for approval. In this case, 47 intervenors would weigh in. All this would be set against the backdrop of a region with a populist tradition and a long history of consumer-owned utilities.

The magnitude of the challenge was enough for Bonderman himself to hold a press conference--the fourth in the firm's history--to announce the deal in November 2003. If Bonderman and his team sought to preempt suspicions, they failed. Why, reporters wanted to know, was the firm interested in buying a regulated utility? After all, Oregon limits the power company's return on equity to 10.5% a year. Wasn't Texas Pacific famous for astronomical performance? Bonderman assured the press that this would be, "for us, a low-return deal." His partner Kelvin Davis, the day-to-day captain on the transaction, insisted that his firm was "not driven by profit. Our interest is in building value over time." The rhetoric made it sound as though Bonderman & Co. had come to Portland on a charity mission.

The arguments for and against Texas Pacific's proposal were clear from the outset. Texas Pacific argued that its ownership would provide stability for a community traumatized by skyrocketing electric rates and the fallout from Enron's bankruptcy. Moreover, the buyout firm argued, ratepayers would also benefit from the "local focus" that would be assured by the creation of an Oregonian-run holding company, which would oversee PGE.

Still, many worried about the $700 million in debt that Texas Pacific was using to fund the acquisition. Couldn't that lead to lower credit ratings, a need to raise rates--or worse? And how much stability would the buyout firm provide? After all, it had every intention of reselling the utility. The deal would rise or fall on Texas Pacific's ability either to convince people of the merits of its proposal or to placate critics by sweetening the conditions for ratepayers. Bonderman emphasized the former strategy.

But from the beginning, Bonderman's diplomatic efforts rankled rather than mollified. He visited Portland city leaders, who had been trying to assemble their own bid for PGE. The Texas Pacific team's supreme confidence grated on the government officials, and Bonderman's candor seemed to get the better of him. "I just don't think the government can do things like this effectively," he told the group, according to city council member Erik Sten, who was present.

Like Enron before it, Texas Pacific misunderstood how different Oregon is from a place like Texas, says Robert McCullough, a former PGE executive who is now a utilities analyst. Oregon isn't the type of place where utility deals are done in a backroom. As McCullough puts it, Oregon "is almost embarrassingly naive. So both companies showed up, asked for the keys to the backroom, and discovered there wasn't a door or a key--or even a room."

Texas Pacific seemed tone-deaf when it came to local dynamics. The investors hired a prominent Portland law firm that had been preparing the city's potential bid for PGE. The law firm dumped the city as its client and signed on with the wealthy outsiders. The sin, if any, was the law firm's, not Texas Pacific's. But the state bar launched a conflict-of-interest investigation (which continues today) into the actions of two of the lawyers. A bad scent was beginning to attach itself to the deal in the press.

Texas Pacific was attempting to convince Oregonians that their plan would offer a great benefit: "local focus." Bonderman had hired an iconic, snowy-maned former Oregon governor, Neil Goldschmidt, as a public emissary and as head of a holding company that would own PGE. Other Oregonians would sit on the board of the holding company. The utility would be run by locals, Goldschmidt explained, not by a bunch of Texans from Enron.

But many Oregonians had their doubts. The entity Goldschmidt was leading was essentially a shell--and it wasn't created to benefit Oregonians. Texas Pacific wanted to avoid potentially deal-killing regulation under a federal law called the Public Utility Holding Company Act. In reality, Texas Pacific could veto virtually any significant decision made by the shell company's board. "Once people learned how little authority the board would actually have," says former utility commission chairman Ron Eachus, "I think it was pretty clear that it was more trying to buy political influence than it was trying to put local community interests first."

Texas Pacific alienated intervenors with its first major sally into the regulatory process in March 2004. It submitted an application for approval that failed to offer a rate cut for customers and that lacked key details, according to Eachus. "They were trying to get by with as little as possible.... I think they were either naive about that, or playing things close to the vest and not giving up what they didn't have to."

As opposition mounted, Texas Pacific's travails were only beginning. In early May came news that rocked the state. A local alternative weekly had learned that in the 1970s, when he was mayor of Portland, Goldschmidt had had a sexual relationship with his kids' 14-

year-old babysitter for at least nine months. Goldschmidt was off the deal, his career in shambles. Bonderman and other Texas Pacific people frantically called intervenors to assure them that they had known nothing about the scandal.

Before Texas Pacific could catch its breath, a second Goldschmidt controversy blew up. This one involved his wife, Diana, and her position on a board that had voted to increase the state pension fund's investment in Texas Pacific on the very day Bonderman had first called her husband about spearheading its bid. Had Texas Pacific rewarded her by hiring her husband? A state investigation ultimately cleared her and the firm--but only after more months of bad press.

Meanwhile, Texas Pacific continued its multifront campaign, with partner Kelvin Davis lobbying local officials and making his case at public meetings. Bonderman did his part too. But even when he succeeded, he seemed to fail. Bonderman lobbied the editorial board of the state's largest paper. He won backing for his bid--but the coverage focused on his inflammatory comments that the city's plan to buy PGE, which was increasingly being touted as an alternative to Texas Pacific, was "delusional" and "a sham."

His opponents were equally direct about sharing their opinions. Erik Sten denounced Texas Pacific as "robber barons" in a speech; placard-waving protesters picketed a speech by Bonderman at the Arlington Club in Portland in mid-September.

The businessmen inside listening to Bonderman may have been more polite than the protesters outside, but they too were concerned by the heavy leverage in Texas Pacific's proposal. PGE would be loaded with enough debt to earn an S&P downgrade for its bonds. Eventually such mainstream companies as Intel, the state's largest corporate employer, would make their opposition known.

By November, Texas Pacific had managed a first in Oregon: It had failed to win over any of the intervenors, including the business groups. The decision was now up to the utility commission, which would act as a court and rule on Texas Pacific's proposal.

But even as the regulators pondered the case, there was one more explosion: In January, sealed documents that Texas Pacific had provided during the regulatory process were leaked to the press. A new wave of bad publicity erupted, this time over "secret documents," which turned out to be Texas Pacific's due diligence. The documents mentioned the possibility of job cuts at PGE and spun out scenarios in which Texas Pacific earned $1 billion on the transaction that Bonderman had proclaimed a "low-return deal." The papers also referred to the structure creating a local holding company as a "PUHCA pretzel"--making it clear that the structure was designed to outwit the federal Public Utility Holding Company Act (PUHCA) and not to benefit customers, as Texas Pacific had repeatedly implied.

Texas Pacific howled in outrage, protesting the illegal disclosure of the documents and insisting that the calculations represented preliminary analysis rather than an actual plan.

Irked by what it considered unfair media coverage, the firm decided to make the documents public. But it didn't matter.

Until that moment, Texas Pacific could still plausibly claim a popular mandate: A poll it had commissioned the previous fall found public support for the proposal. But whatever support did exist--and plenty of critics doubted the poll's accuracy--evaporated. E-mails against the deal rained into the utility commission. State senators, after launching hearings on the deal, initiated legislation to strengthen regulatory laws.

Texas Pacific partners, accustomed to a sterling reputation in the buyout community, seemed taken aback at being declared in effect Public Enemy No. 1. Time and again, they say, they reached out to local parties, both directly and by hiring top-notch people like Goldschmidt--only to be rebuffed. They deny being recalcitrant in negotiations and insist that their offer was more than fair. In their minds, much of the resistance was political, and there just wasn't anything they could do about that.

Despite the constant blows to Texas Pacific, most observers expected that regulators would offer Texas Pacific some form of approval, dependent on the acceptance of a series of conditions. And so when the decision was finally announced on March 10, it was shocking in its bluntness. The answer was no, plain and simple. No conditions. No ambiguity. "We conclude that the application fails to serve the customers of PGE in the public interest," the decision stated.

TEXAS PACIFIC HASN'T ANNOUNCED HOW it will proceed. If it wants to fight on, it can appeal the decision or reapply. Either will cost more time and effort, and the firm would probably need to up its investment, thus reducing the effective return. The firm's history suggests it won't do that. It has willingly walked away before, most recently in its bid for US Airways last summer. When the price rose above what Texas Pacific was willing to pay, the company just said goodbye.

Of course, this time will be different. If and when Texas Pacific leaves Portland, it will be because it was chased out by a posse that viewed it as a bunch of Enronesque corporate outlaws from Texas. That's much more painful than the seven or eight million the firm spent out of pocket on the deal.

Still, Bonderman isn't the type of person to sit around agonizing about his image. He will no doubt stick to what he does best: juggling a lot of balls and making a lot of money. In just the past few months he and his firm have announced they are cashing out their position in Korea First Bank (the investment tripled in five years); begun preparing a sale of stock in silicon-wafer maker MEMC (on which Texas Pacific transformed a $6 investment--you read that right: six dollars--into a stake worth more than a billion); boosted its bid for a chemical manufacturer named British Vita; and declined to respond to dubious rumors that it will buy clothing retailer Lands' End. Meanwhile, Texas Pacific's venture arm decided to fund a tech startup, and the Irish discount airline Bonderman chairs, RyanAir, announced it is buying some 737s. Then there are the nine other corporate and charitable boards on which he sits.

And, of course, he'll continue scouting for new deals--perhaps even a blockbuster or two. Either way, he'll prefer it if they don't require a lot of public scrutiny. Then he can move back behind the curtain. It's easier to be the wizard there.