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# Defending a Colossal Flop, in His Own Way

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**S**ITTING on the witness stand in a tiny courtroom in northern Connecticut last week, Theodore J. Forstmann looked every bit the Wall Street Master of the Universe that he is. He just didn't sound like one.

"What is a junk bond?" a lawyer inquired.

"You're really asking the wrong person," Mr. Forstmann replied.

Indeed, the usually loquacious Mr. Forstmann, who made billions of dollars for investors by betting on buyouts like Gulfstream Aerospace, Dr Pepper and General Instrument in the 1980's and 90's, appeared visibly frustrated and at times incapable of answering the most basic questions about his business.

"Frankly, this is kind of over my head," he told the courtroom at one point, when asked a question related to the structure of one of his deals.

"I cannot answer that to your satisfaction," he responded to another question, wearing a pained look on his face. "Can I get some water?"

Mr. Forstmann was in court to explain his biggest flop: how he managed to lose \$2 billion of his investors' money gambling on two upstart telecommunications companies, [XO Communications](#) and [McLeodUSA](#), just before the entire industry collapsed in 2001.

In an unprecedented case that, if successful, could potentially cripple Mr. Forstmann's business and expose legions of other private equity firms to debilitating lawsuits from their own investors, Connecticut's attorney general and state treasurer have sued him and his firm, Forstmann Little & Company, contending that they invested improperly and lost \$125 million of the state's pension fund money.

The state has accused the firm of a bait-and-switch scheme: luring the state's pensions to invest with the fund on the promise of a conservative investment strategy and then pursuing highly speculative deals.

"This case is not about simply a failed investment," Gerald J. Fields, the lead lawyer for Connecticut, said in State Superior Court in Rockville, Conn., a hamlet about 130 miles northeast of Manhattan, during his opening statement, accusing Forstmann Little of breach of contract and fiduciary duty. "The firm invested in two high-risk ventures that Connecticut had not bargained for."

Forstmann Little's lawyer, Fred Bartlit, who represented the Bush campaign in the 2000 Florida recount, said the case was without merit. Mr. Bartlit, a commanding figure with a booming voice, argued in the court that the deals were explicitly permitted under the agreement signed by Connecticut. He said the state was now simply engaged in Monday-morning quarterbacking, trying "to rewrite the contract in court."

Indeed, he pointed out that Connecticut never complained about the investments in question - which were all disclosed to the state before they were made and initially rose in value - until they began to lose money. He also told the court that every other investor in the fund, like [General Electric](#) and [Boeing](#), refused to join Connecticut's suit and that almost all of them reinvested in Forstmann Little's subsequent fund.

Experts describe Connecticut's case - which hinges in large part on legal interpretations of a 130-page contract between Forstmann Little and Connecticut - as a crapshoot. Critics have called the case political grandstanding by the state's treasurer, Denise L. Nappier; she has denied that accusation.

Even the judge has seemed somewhat skeptical of the state's accusations, regularly interrupting Mr. Fields and telling him that his line of questioning is "irrelevant."

BUT Connecticut may have an ace up its sleeve: unlike many complicated contractual disputes, this one will be decided by a jury, not a judge schooled in the intricacies of contract law. And in some ways, the jurors, as Connecticut residents and taxpayers, are the home team. If the pensions were to go belly up, Connecticut taxpayers would probably have to foot the bill.

That is why Mr. Forstmann's performance on the stand was so important. It was his chance to establish what jury consultants call the "likability factor."

Mr. Forstmann, 64, one of Manhattan's most prominent philanthropists and bachelors, is a charmer by nature - and over the years has been linked in the gossip pages to both Elizabeth Hurley and Diana, Princess of Wales. But by most accounts, he did not come across that way on the stand. When answering questions, he often quibbled and parsed words. Early in his testimony, Mr. Fields asked, "Would it be fair for me to say that no major decision in Forstmann Little is made without your approval?"

Mr. Forstmann replied, "It would depend what you mean by major."

Parsing words on the stand is not a new phenomenon among top corporate executives who are more

accustomed to asking the questions than answering them. Bill Gates, [Microsoft's](#) chairman, among others, have responded in similar fashion.

At another point in the testimony, Mr. Fields seized on Mr. Forstmann's increasing irritation, trying to make the case personal by grilling him about his net worth.

"That's part of the case?" Mr. Forstmann retorted, clearly exasperated.

Pressing the issue, Mr. Fields questioned whether Mr. Forstmann had personally invested \$6 million in XO Communications as a ploy to raise confidence in the stock. "That \$6 million is a de minimis portion of your net worth, isn't it?" he asked, over the objection of Mr. Bartlit.

"Six million dollars is a lot of money to me," Mr. Forstmann responded.

Mr. Fields parried, "It's a lot of money to most people, but it's less than 1 percent of your reported net worth, isn't it?"

Mr. Forstmann ducked the question.

To some spectators, the tone of his answers appeared even more peculiar, considering that he had practiced his testimony in front of mock juries before the trial, according to his legal team.

Mr. Bartlit, his lawyer, did not appear to be helping matters, either. When Mr. Bartlit's computer stopped working during a presentation, Judge Samuel Sferrazza asked him if he needed any help. "No, no, I'm fine," he replied. "I do this all the time," he added, appearing unwilling to concede the need for assistance. After he got the computer running again, his presentation software shut down and a picture of his dog popped up, prompting laughter from the jury and spectators.

Personalities aside, the biggest portion of the case - which could last several more weeks - is expected to focus on the arcane details of contract law.

Connecticut's case contends that Forstmann Little misrepresented its investment approach in a piece of promotional literature called a private placement memorandum, which the state considers part of the contract it signed with the firm.

The private placement memorandum described, among other things, Mr. Forstmann's investment approach, noting his desire to take full control of companies and his aversion to big leverage. But in the case of McLeodUSA and XO Communications, Forstmann Little shifted strategies. It bought a minority stake in both companies, which were highly leveraged.

Forstmann Little argues that the private placement memorandum is simply an outline, and not part of the

contract that Connecticut signed. Indeed, the contract explicitly states that it supersedes all previous agreements.

Mr. Forstmann also maintains that the language in the contract is broad enough to allow the firm to do what it wants. It defines the types of deals the firm can do as any acquisitions of "another business entity or a significant percentage of the outstanding securities or assets of another business entity."

Connecticut argues that the phrase "significant percentage" is ambiguous. In any event, Mr. Forstmann said that despite taking a minority position in the companies in question, "from my point of view, we had a great deal of control and influence."

Still, the state says that even if Forstmann Little did not breach that part of the contract, it violated other provisions that limited the amount of money the firm could invest in any given company. The state says it exceeded that limit in both XO Communications and McLeodUSA. Forstmann Little contends that Connecticut is misinterpreting the contract.

But Mr. Forstmann and his accusers are in agreement about the outcome of the firm's investment. After all the hemming and hawing on the stand, Mr. Forstmann, in perhaps his most direct and heartfelt answer, did acknowledge the losses suffered by his firm and Connecticut.

"It's the first loss that I have had in a company - the first real loss," he said. "I am still sad about it. I am still unhappy about it. You know, I took each of these investments very seriously. I took my relationship with all my limited partners very seriously. I'm very, very - I'm very unhappy about it."