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Wall Street Goes to War

[Nathan Vardi](#), 07.15.09, 06:00 PM EDT
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The battle for wartime profits is waged in the boardroom. Inside the most lucrative--and the ugliest--deal of the Iraq and Afghan wars.



Thomas Campbell (left); Robert McKeon

For 19 years Robert McKeon and Thomas Campbell were inseparable. They raised money and struck deals together, buying and selling dozens of companies, often in the defense sector--smallish outfits such as Athena Innovative Solutions, Integrated Defense Technologies and Vertex Aerospace. Working 12-hour days out of next-door offices in midtown Manhattan, they could hear each other's phone conversations and knew the most personal details about each other. They golfed together, went skeet and trap shooting, traveled together for meetings and once shared a hotel room in Mexico. On Fridays they would dine, just the two of them, at Harry Cipriani, the ritzy Manhattan restaurant. "I believe we were pretty close to best friends," says Campbell.

They also hatched the most lucrative deal of the wars in Iraq and Afghanistan. Their 2005 purchase of [DynCorp International](#) ([DCP](#) - [news](#) - [people](#)), the Falls Church, Va. provider of services to the U.S. military, landed McKeon and Campbell at the center of a booming and controversial business. The leveraged buyout also helped rip apart their relationship. McKeon ended up very rich, personally earning \$350 million, or seven times his investment, and in control of a company that has emerged as the biggest winner in the war game. Campbell, forced out of DynCorp, came away with very little and has started over. Today the two former friends are locked in mortal combat--trading accusations of greed and betrayal in protracted litigation and competing for \$25 billion a year in battleground services contracts for the U.S. government.

Battlefield contractors have been around for years. But their importance has grown in post-Cold War defense spending. Roughly 240,000 contractor employees, many of them foreign nationals, support U.S. missions in Iraq and Afghanistan, outnumbering the troops they serve. They provide security, military and police training, logistics and air support, reconstruction and every mundane service it takes to feed, clothe and clean fighting forces--collecting some \$100 billion of the \$830 billion U.S. taxpayers are on the hook for in the two wars. Though they don't operate under the same rules of engagement as the U.S. military, contractors risk their lives; 1,360 of them have been killed and 20,000 injured in the two war zones.

Contractors have drawn fire because of high-profile scandals. KBR, split off from [Halliburton](#) ([HAL](#) - [news](#) - [people](#)), has prepared 937 million meals, issued 7 billion gallons of fuel and driven 745 million miles moving soldiers and supplies but has been dogged by accusations of negligence and overbilling. Titan Corp., now part of L-3 Communications, and CACI International were caught up in prisoner abuses at Abu Ghraib (neither company has been prosecuted). Blackwater USA, a private security firm renamed Xe Services, had been protecting U.S. diplomats in Iraq but got kicked out of the country after its employees killed civilians in Baghdad's Nisur Square in September 2007.

Yet the business keeps growing--for giants like KBR (annual sales: \$11.6 billion) and SAIC (\$10.1 billion), which manages the delivery of mine-resistant vehicles, and for smaller private firms like Triple Canopy, which does security work, and IAP Worldwide Services, helping to generate power at forward operating bases. Defense Secretary Robert Gates is trying to curtail outsourced jobs, suggesting in April that they be reduced from 39% of the Pentagon's workforce to 26%, largely by hiring civil servants to handle the acquisitions process. But Gates and his war planners have shown little inclination to get people in uniform to turn wrenches, peel potatoes, build bases, drive trucks or protect diplomats. "There is no intent not to have contractors in the battlefield--I am not uncomfortable with a 1:1 ratio," says Jacques Gansler, former Under Secretary of Defense in the Clinton Administration and chairman of a 2007 commission that urgently called for contracting reform. "Issues need to be resolved," he says, "but you can't get along without them."

President Obama sent 20,000 additional troops this summer to Afghanistan to go after the Taliban. DynCorp will be at the forefront of that action, training Afghan police, building barracks, managing poppy eradication and providing U.S. troops with laundry, fuel and meals in the war's biggest new contract. That's on top of big deals in Iraq, airlifting and protecting diplomats and supplying combat interpreters.

How did McKeon, 54, and Campbell, 50, get into this racket? Improbably. Born in the Bronx, McKeon, the son of a Drake's cakes deliveryman, got a B.A. from Fordham University, then worked his way through Harvard Business School to Wall Street, becoming head of private equity at Wasserstein Perella & Co., the investment bank founded by Bruce Wasserstein and Joseph Perella. McKeon, a registered Democrat who contributes to both parties, is a member of the Council on Foreign Relations and once contemplated running for governor of Connecticut.

At Wasserstein McKeon became known for cosmetics, scoring a profitable deal for Maybelline. In 1988 he hired an accountant who also came from a relatively modest household north of Manhattan. Tom Campbell grew up in Ardsley, N.Y., sharing a bedroom with his two brothers, graduated from Lehigh University and did acquisition finance at Manufacturers Hanover Trust Co. before working on deals for McKeon at Wasserstein.

Four years later, weary of sharing profits with better-known founders, McKeon left to start his own investment firm, Veritas Capital. Campbell joined him, and they started buying companies with their own money, often reaching out to big shots like Harold (Red) Poling, chief executive of [Ford Motor](#) ([F](#) - [news](#) - [people](#)), and George Keller, chief executive of [Chevron](#) ([CVX](#) - [news](#) - [people](#)), to invest deal by deal.

By 1996, when they had raised \$175 million for Veritas' first private equity fund, McKeon and Campbell had taken an interest in military suppliers. To run their fund they formed a management company, with McKeon holding 62.5% and Campbell 37.5%. After some profitable defense deals they raised another \$153 million fund in 2002 and split the general partnership the same way; their biggest backer was [Credit Suisse](#) ([CS](#) - [news](#) - [people](#)). For help navigating the defense bureaucracy, Veritas created an advisory board that included retired generals such as Barry R. McCaffrey and Anthony C. Zinni.

Then they hit pay dirt. On the eve of the Iraq war DynCorp, the legacy of two aviation-support firms formed in 1946 that provided depot-level repairs for the Air Force, had become a government contractor known as much for its information technology work as its paramilitary services. [Computer Sciences Corp.](#) ([CSC](#) - [news](#) - [people](#)) bought the company for \$622 million in 2003, but the data processing firm clearly didn't know what to make of DynCorp's military support businesses.

Veritas did. McKeon and Campbell had made a killing buying Raytheon Aerospace, a provider of maintenance services for military aircraft, renaming it Vertex and selling it for \$650 million to L-3 Communications. "Follow the plane, because

wherever the plane goes you want to touch all aspects of it," says Campbell, explaining the logic of such deals. "The parallel for DynCorp was follow the soldier, because behind every military individual is a long supply line." He and McKeon swooped in the moment DynCorp's nondata services business went up for sale. Campbell flew down to Fort Worth, Tex. to dig through the company's books and contracts. He discovered that Computer Sciences' offering memo was undervaluing the assets. McKeon struck a deal in fall 2004 to buy those assets for \$850 million. But in the time it took for the transaction to close, investment banks like [Goldman Sachs](#) ([GS](#) - [news](#) - [people](#)) took a look at Campbell's and McKeon's assessment of their target and came to a startling conclusion: Veritas could quickly make five times its money by taking DynCorp public after closing and squeezing out a dividend equal to its original investment, court documents say.

There was jubilation at Veritas' midtown Manhattan offices. The firm needed to put up only \$100 million of equity to make the deal happen. A potential windfall, however, turned contentious: Veritas' current fund, limited in what it could front, was capped at making a \$38 million investment; Northwestern Mutual Life Insurance was good for an additional \$14 million. Veritas insiders were thrilled to make up the difference by each chipping in various amounts. Court filings suggest that Campbell expected to get a sizable piece of the action.

Not so. McKeon took the entire investment opportunity for himself, putting up \$48 million of his own, according to court documents. Because he put up the cash, McKeon also received half the \$10 million transaction fee that DynCorp paid when the deal closed in February 2005, court papers show. There was more: A year later DynCorp went public on the New York Stock Exchange, using the proceeds to pay its equity sponsors a \$100 million dividend, taking their original investment off the table.

DynCorp's filings with the Securities & Exchange Commission do little to reveal the size of McKeon's personal stake (he declined requests to comment). His share ownership is lumped together with the Veritas buyout fund and Northwestern Mutual stakes in DIV Holding, an entity that has 56% of DynCorp. The offering prospectus and nearly all subsequent filings say McKeon "disclaims this beneficial ownership, except to the extent of his pecuniary interest" in DIV Holding. A footnote in a single 13D filing made in May 2006 is just about the only public disclosure of that interest, acknowledging that McKeon is the sole member of a company that owns 45% of DIV Holding. Bottom line: McKeon owns one-quarter of DynCorp, shares recently worth \$270 million. He also is due to receive 12.5% of the buyout fund's investment gain from DynCorp--currently \$25 million or so--when its holdings are cashed out. Campbell's stake, by comparison, is negligible.

Whatever feelings of betrayal he may have had, Campbell joined DynCorp's board with McKeon, who served as chairman. As the conflicts in Iraq and Afghanistan boomed, DynCorp prospered. These days 53% of its revenue comes from the battlefields. Last year DynCorp's 51%-owned joint venture secured a \$4.6 billion

multiyear contract to supply 9,100 linguists to translate for U.S. soldiers in Iraq. Amid a worldwide recession, that contract helped boost DynCorp's revenues by 45% in the year ended Apr. 3, when the company earned \$70 million on \$3.1 billion of revenue and had paid down its debt, to \$600 million.

Campbell was forced out of DynCorp and Veritas two years ago and has been playing catch-up ever since. Shortly after, he moved to Washington, where he founded dc Capital Partners, an investment firm that looks a lot like Veritas. It even has an advisory board with onetime generals such as Zinni and Michael Hayden, and former Deputy Secretary of State Richard Armitage. Campbell tried to raise money but scrapped those plans when the credit crisis hit. He does have the backing of investment groups like Solar Capital and Alcentra. Last year, when Triple Canopy considered putting itself up for sale, Campbell showed some interest but never made a bid.

Campbell has assembled four defense and intelligence companies. One of them, National Interest Security, is in the black, he says, with revenue of \$200 million and 967 employees. More than half of its contracts are classified, doing things like capturing and data-mining cell phone traffic and assessing the effectiveness of satellites. Another outfit, Kaseman, is wiring up buildings in Iraq and Afghanistan and will probably compete at some point with DynCorp for police training contracts.

Meanwhile, DynCorp has profited from the public embarrassments of Blackwater and KBR. After the Iraqi government revoked Blackwater's operating license, the State Department in June awarded to DynCorp a \$915 million, five-year contract to provide air transport and security for U.S. diplomats.

Last year DynCorp wiggled into the biggest spoils of all--the Logistics Civil Augmentation Program, or Logcap, a huge contract once awarded exclusively to KBR. It's catchall stuff: providing laundry, mail, food, water, fuel, power, sanitation, living quarters, construction and (the most dangerous service) transportation. Logcap generates thin profit margins but large and steady revenue; since the outset of the wars KBR has earned an estimated \$700 million of income (before interest and taxes) on \$31.4 billion of revenues off of Logcap. Now DynCorp will compete with KBR and [Fluor Corp.](#) ([FLR](#) - [news](#) - [people](#)) for up to \$50 billion of these orders over the next decade. In July DynCorp won a five-year, \$5.9 billion deal to supply support services in southern Afghanistan.

DynCorp Chief Executive William Ballhaus is counting on Logcap work in Afghanistan and Iraq--even as U.S. troops in Iraq withdraw from the cities and the war there winds down--to provide most of the company's near-term growth. "In Iraq we actually think we will see an increase in our business largely driven by the logistics efforts required to reposition the personnel and equipment," says Ballhaus, whom McKeon plucked from BAE Systems. In the last year Ballhaus has traveled to Afghanistan four times, overseeing DynCorp's expansion of services to train Afghan

police under a \$3.8 billion State Department contract and the instruction of U.S. soldiers in manning mine-resistant vehicles. Ballhaus says the trips also let him convey the importance of his compliance and ethics program. "Given the areas in which we operate, it's an important dialogue for me to have with them personally," he says.

But no battle plan survives engagement with the enemy. The State Department is currently investigating whether DynCorp ignored drug abuse by its employees in Afghanistan after one of them died in Kabul from an apparent overdose. As part of an age discrimination suit filed in February, Gregory Caul, a former DynCorp arms instructor in Afghanistan, claims company employees shot at unarmed Afghan children who were hanging out at a shooting range to pick up brass casings they could sell for cash. "The men shot their weapons in the direction of the children for sport," claims Caul. DynCorp declines to comment on Caul's specific allegations or the State Department investigation into possible drug abuse (but of course recites that it investigates allegations of misconduct carefully).

Afghanistan is a tough assignment, and the deteriorating security situation has hurt DynCorp's construction work on Afghan army barracks in Jalalabad and Kunduz. The company has had to move people and equipment through the air instead of by trucks, leading to delays and soaring costs. That is killing the profit in this fixed-price deal (losses so far: \$38 million). Ballhaus vows not to bid on any similar fixed-price jobs in Afghanistan. The cost-plus alternative means less risk but also less reward.

McKeon may well sustain more collateral damage--in the courts. Campbell never got over being squeezed out of the DynCorp deal, and believes McKeon plotted to cut him out of Veritas. Last year, when negotiations between them broke down, they sued each other in New York State court in Manhattan, both alleging breach of contract.

In his suit McKeon claims that he fired Campbell because Campbell violated his contracts with Veritas by personally buying Internet marketing assets from [Omnicom Group](#) ([OMC](#) - [news](#) - [people](#)) eight years ago. McKeon adds that, when Campbell first proposed the deals, McKeon instructed him not to pursue them. McKeon claims he had no idea Campbell had gone ahead until 2006, when the transactions became the subject of a securities class action, which alleged sweetheart deals were arranged to hide Omnicom losses. (The class action was dismissed and is now on appeal.) Campbell denies the allegations.

For his part, Campbell alleges that McKeon used the Omnicom deals as a pretext to oust him from Veritas. Campbell further claims that his ouster helped McKeon to increase his profits while shrinking Campbell's share in their partnerships. McKeon, the suit continues, breached his contract and is withholding the personal capital Campbell put up in Veritas' investments, plus the resulting profits. McKeon claims all his actions have been aboveboard.

"There is a lot of money involved, and my work helped create a lot of value that I feel I am owed," says Campbell. "I can't just walk away, but I have moved on with my life." The suits grind on, stuck recently on whether Schulte Roth & Zabel, Veritas' longtime law firm, can represent McKeon.

If war is hell, so is Wall Street.