Michael Steinhardt's 1991 Corner of the U.S. Treasury Market

by Richard Freeman

In 1991, Michael Steinhardt, in coordination with Salomon Brothers, conducted one of the biggest corners of the U.S. Treasury market in U.S. history, turning America's sovereign debt into a speculative plaything. It was an attack on the sovereignty of the United States.

Steinhardt is the son of the notorious Sol "Red" Steinhardt, a leading figure in the Meyer Lanksy National Crime Syndicate (see "The Real Scandal: McCain and Lieberman," *EIR*, July 19, 2002). Michael Steinhardt fronted his father's ill-gotten gains into several financial vehicles and Wall Street investments, which eventually evolved into his Steinhardt Management Co., one of the world's largest and dirtiest leveraged hedge funds. During the 1980s and 1990s, Steinhardt used his hedge fund to enforce a major transformation: building up the U.S. speculative bubble, and destroying the productive economy and necessary economic-financial institutions in America and around the world.

Meanwhile, Steinhardt became critical to the election of Joe Lieberman (D-Conn.) to the U.S. Senate. In the mid-1980s, Steinhardt helped create and finance, and then chaired, the Democratic Leadership Council (DLC), as a vehicle to crush both the legacy of Franklin D. Roosevelt and any support for the Constitution's General Welfare clause inside the Democratic Party. The DLC helped finance and steer Lieberman's career. When Steinhardt stepped down as DLC chair in 1995, Lieberman took over that post. In 1991, Steinhardt formed the secretive Mega group of approximately 50 billionaires, which supports the war drive of the fascist Ariel Sharon government of Israel, and is a major force behind the "Clash of Civilizations" policy that was advanced with the Sept. 11 attacks. The Mega group both finances and sets a good deal of the policy for its empty, but dangerous vessel, Joe Lieberman.

Steinhardt's menacing 1991 Treasury corner offers a clinical study of the thinking and criminal behavior of those who would use Lieberman to destroy America today.

Strategic Implications

In his 1991 Treasury raid, Steinhardt made as much as hundreds of millions of dollars, and paralyzed a portion of the U.S. Treasury market. *EIR* is investigating other strategic functions this raid might have had, given that it was launched at a time when the U.S. banking system was collapsing, and a few short months after the start of Operation Desert Storm against Iraq.

The Securities and Exchange Commission (SEC) and the U.S. Department of Justice (DOJ) jointly brought charges against Steinhardt and a closely allied hedge fund, Caxton Corp.,[1] for violating the Sherman Anti-Trust Act and conspiracy in illegally manipulating and squeezing the Treasury market. In 1994, Steinhardt and his associates settled the case by paying $76 million in fines and settlements—one of the largest fines in U.S. history. But it appears he should have faced criminal charges as well. *EIR* is investigating who operated on his behalf to keep him out of jail.

In the joint SEC-DOJ complaint, *United States of America v. Steinhardt Management Company; and Caxton Corporation*, the DOJ and SEC state: “The complaint alleges that, beginning in April 1991 and continuing into September 1991, the defendant entities and others (collectively, the ‘conspirators’) violated Section 1 of the Sherman Act by agreeing to coordinate their actions in trading the two-year Treasury notes auctioned by the United States Treasury on April 24, 1991 (‘April Notes’). During that period the conspirators coordinated trading in the secondary markets for the April Notes.”

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,         :
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               Plaintiff,         :
                                  :
          - v -                   :
                                  :
STEINHARDT MANAGEMENT COMPANY,    :     94 Civ. 9044 JMP
INC.; and CAXTON CORPORATION,     :
                                  :
               Defendants,        :
                                  :
          -and-                   :
                                  :
$12,500,000 THAT IS THE PROPERTY  :
  OF STEINHARDT MANAGEMENT        :
  COMPANY, INC.;                  :
                                  :
          Steinhardt Management   :
            Company, Inc.,        :
          Real Party in Interest  :
                                  :
          -and-                   :
                                  :
$12,500,000 THAT IS THE PROPERTY  :
  OF CAXTON CORPORATION,          :
                                  :
          Caxton Corporation,     :
          Real Party in Interest. :
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                 COMPETITIVE IMPACT STATEMENT
     Pursuant to Section 2(b) of the Antitrust Procedures and Penalties
Act, 15 U.S.C. § 16(b)-(h), the United States submits this Competitive
Impact Statement relating to the proposed Final Judgment submitted for
entry in this civil antitrust proceeding.

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                                   I.
                 NATURE AND PURPOSE OF THE PROCEEDING
     On December 16, the United States filed a civil antitrust complaint
alleging that Steinhardt Management Company, Inc. ("SMC"), Caxton
Corporation ("Caxton") and others conspired to restrain competition in
markets for specified United States Treasury securities, in violation of
Section 1 of the Sherman Act, 15 U.S.C. § 1.  The complaint seeks
injunctive relief and forfeiture of property owned by SMC and Caxton
pursuant to the alleged conspiracy under Section 6 of the Sherman Act,
15 U.S.C. § 6.
     The complaint alleges that, beginning in April 1991 and continuing
into September 1991, the defendant entities and others (collectively,
the "conspirators") violated Section 1 of the Sherman Act by agreeing to
coordinate their actions in trading the two-year Treasury notes
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There are two points about a Treasury auction that make the significance of Steinhadt’s action clear. First, for a week prior to and a few weeks after a Treasury auction, investors can buy this Treasury in what is called the “when-issued” or primary market. After that market is closed, investors can buy that Treasury security in the secondary markets (which are of two types: either the cash secondary market, or the financing secondary market).

Second, each Treasury auction issues Treasury securities that are unique to that auction. In each auction, which occurs on a specific date, every Treasury security is given an identification number, called the CUSIP number, which is the same for all securities issued on that date. So, for the April 24, 1991 auction of two-year Treasury notes—which Steinhardt cornered—an investor who wished to trade in those notes, which included those who took a short or long position, when it came time to make delivery, had to deliver a two-year Treasury note which carried *the specific CUSIP number connected to April 24, 1991*. In most cases, an investor could not fulfill the contract by substituting another two-year note with a different CUSIP number. As a seasoned speculator, Steinhardt knew this.

Starting in May, a few weeks after the April 24, 1991 two-year Treasury note had been issued, Steinhardt and his co-conspirators began their squeeze: They bought or controlled $20 billion worth of the $12 billion in April 24, 1991 two-year Treasury notes that had been issued; that is, they controlled more than 150% of the issue. Those investors who had taken a short position, i.e., bet that the price would fall, could not obtain the notes with the specific CUSIP number in the

1. The case makes clear that in the April 1991 two-year Treasury note squeeze, Steinhardt’s co-conspirator was Bruce Kovner, of Caxton Corp. Kovner got his start beginning in the early 1980s working for Lord Jacob Rothschild, and then for Global Asset Management, which was set up and controlled by the late Baron Edmund de Rothschild. Rothschild financed and put into business Bernie Cornfeld, Robert Vesco, and Drexel Burnham Lambert. Kovner and Steinhardt are close: According to DOJ-SEC records, starting in 1990 Kovner became president of Steinhardt Management for one year. Today, Kovner shows up in several important posts: In 2001, he became vice-chairman of the American Enterprise Institute, one of the leading institutions pushing for a “Clash of Civilizations.” At the start of 2002, he joined the board of *The Sun*, a newspaper set up by Hollinger Corp. (Steinhardt is also on the board of *The Sun*). Kovner is also one of the biggest funders of the “school vouchers” movement, and a member of the Publication Committee of Irving Kristol’s *Public Interest* magazine.

secondary market to cover their short position. Not only did they suffer large losses (and in some cases, apparently, default on their contracts), but in their attempt to get their hands on the two-year notes, *they bid the price of the two-year notes up.* There were others who were not short-sellers, but who had reasons to want to purchase two-year notes. They also could not obtain the notes.

Steinhardt and his co-conspirators had taken long positions, betting that the price of the two-year Treasury notes would go up. Further, Steinhardt worked with dealers to prevent anyone else from getting their hands on two-year notes. As they tightened the squeeze, the price rose, and Steinhardt et al. made a financial killing.

The SEC-DOJ complaint describes what happened: "Beginning in or about April 1991, the defendant entities agreed on a scheme to acquire control of the supply of April Notes and to limit the supply of the issue in the cash and financing markets in order to cause a squeeze. This scheme ensured that persons who had sold notes short in the when-issued market or the post-settlement cash market could obtain such notes only by purchasing them at artificially high and non-competitive prices in the cash market. . . . This course of conduct continued for a period of time during which the defendant entities, with the assistance of others earned supracompetitive rates on transactions in the April Notes.

"Through numerous purchases made through various dealers, in the when-issued market, the cash market, and at auction, SMC [Steinhardt Management Co.] and Caxton obtained substantial positions in the April Notes. Indeed, from May until mid-September 1991, the defendant entities controlled more than the 'floating supply' of the issue [i.e., more than 100%], giving them the power to cause short sellers of the April Notes to fail to meet their security-specific delivery obligations."

The complaint discusses how SMC and Caxton "gave tacit assurances to each other that they would continue to hold their substantial long positions in the April Notes, and would limit the supply of April Notes that they would make available . . . to the markets."

The SEC-DOJ complaint also discusses how they colluded with primary Treasury dealers to restrict supply of April notes: "The conspirators began to implement their squeeze on May 23, 1991. An essential part of the scheme involved the defendant entities entering into financing agreements with two primary dealers to ensure that the supply of April Notes available to shorts in the secondary market would be reduced."

The Timing of the Squeeze

The timing of the squeeze is interesting in light of world events. In February 1991, President George H.W. Bush invaded Iraq. As often happens during war, Desert Storm sent investors around the world fleeing into the "safe investment" of U.S. Treasury securities. The increased demand sent the price of all Treasuries—ranging from one-year bills to two-year notes, to 30-year bonds—upward. In the Spring of 1991 the war ended, but the ensuing tension kept the purchase of U.S. Treasury securities high. This heightened the already strangling effect that the Steinhardt corner had on the two-year Treasury notes market, pushing their price even higher, destroying the shorts.

There may be strategic considerations involved in Steinhardt's decision to corner the market in Treasury notes when he did, which further investigation will perhaps reveal. There certainly were things happening in the financial realm. Before discussing them, let us consider three other points.

First, Steinhardt made a lot of money from the corner operation, which, according to the DOJ-SEC complaint, was carried on for five months. It is very possible that this operation alone yielded a $200 million profit. In his recent book, *No Bull,* Steinhardt states: "Despite the enormous burden of the Treasury scandal, our bond bet had been a huge win for our investors. From mid-1990 through 1993, we had made more than $600 million on our interest-rate view." What Steinhardt called "our interest-rate view," means that Steinhardt bet on the direction of U.S. interest rates, and the way one does that, most of the time, is through bets on U.S. Treasury securities.

Second, Steinhardt paralyzed part of the U.S. Treasury market, with significant consequences. The DOJ-SEC complaint states: "The conspiracy had a dangerous probability of damaging the Treasury of the United States. As noted in the *Joint Report on the Government Securities Market* issued by the Treasury, the SEC, and the Federal Reserve Board, 'an acute, protracted squeeze resulting from illegal coordinated conduct, such as the one alleged here, 'can cause lasting damage to the marketplace, especially if market participants attribute the shortage to market manipulation.' " Above all, this represented an attempt to *disrupt and render ineffective a part of the market of the sovereign debt of the United States.* In addition to directly causing a monetary loss to the U.S. Treasury, the Steinhardt attack disrupted the Treasury market, upon which the United States depends to finance its budget deficit and for other purposes.

Part of a Bigger Operation

Third, immediately afterward, Salomon Brothers investment bank set up a squeeze for U.S. Treasury two-year notes dated for May 1991. Salomon was charged by the SEC and DOJ with "colluding with unnamed parties." One newspaper article suggested that Salomon Brothers and Steinhardt Management participated with each other in the squeezes of the April two-year Treasury notes and the May two-year Treasury notes. This indicates that a larger operation was afoot.

A proper investigation also requires looking at the strategic financial picture at the time. In the Spring of 1991, Citibank, then America's largest bank, had gone under, and under the terms of a Memorandum of Understanding that Citibank signed with the Federal Reserve Board, the Fed had sent hundreds of inspectors and other government officials into the bank to run it on a life-support system, to keep it, and the American banking system, from collapsing. Did there exist a relationship between the Steinhardt and Salomon corners/squeezes, and Fed Chairman Alan Greenspan's attempt to save Citibank and other banks?

Further, in September 1992, George Soros's Quantum Fund launched an attack against the British pound, which made Soros a lot of money, and also broke Britain out of the European Rate Mechanism. Speculative raids, while designed to make a lot of money, are frequently enfolded within an operation that also is meant to enforce a policy shift. Could the Steinhardt/Salomon attacks have involved enforcing a major policy shift? Is there a broader policy continuity between the Steinhardt and Soros raids?

The SEC-DOJ Investigation

In June 1991, the SEC began an informal investigation of the U.S. Treasury markets, and in August 1991 it turned this into a formal investigation and issued subpoenas to Steinhardt and others. Throughout 1992, the SEC Enforcement Division's investigation continued. In the meantime, starting some time in 1991, civil suits commenced against Steinhardt and other defendants. On Dec. 16, 1994, the DOJ and SEC announced that "two of the country's leading investment fund managers, Steinhardt Management Company, Inc. and Caxton Corporation, have agreed to pay $76 million to settle antitrust and securities charges" which had been filed by the DOJ and SEC in the U.S. District Court in New York City.

Steinhardt Management had to pay $40 million, of which $12.5 million was to be forfeited to the United States under the antitrust laws, $6.5 million was to be paid to the SEC as a penalty for violating the securities laws, and $21 million was to be placed into a disgorgement fund to be administered by the courts to compensate victims of the violation.

Steinhardt himself makes clear that the Steinhardt corner and the Salomon Brothers corner were viewed by the victims and others as effectively one operation. In *No Bull*, Steinhardt writes, "Eventually a large group of small investors filed a number of class-action suits, later rolled into one suit, against Salomon, Caxton, and Steinhardt."

The Steinhardt squeeze on the U.S. Treasury market was more severe than that of Salomon Brothers. The Dec. 16, 1994 *Wall Street Journal* said, "The [Steinhardt] April 1991 note squeeze, known as the 'forgotten squeeze,' received less attention than the May 1991 squeeze on two-year Treasury notes, which led to the Salomon Brothers, Inc. Treasury-auction scandal. But some market participants say the April squeeze was more severe."

Why Didn't Steinhardt Go to Jail?

While the DOJ and SEC brought a civil case against Steinhardt, it would appear that they should have brought a criminal case, which could have meant jail time for Steinhardt. Today, the DOJ brings criminal charges for insider trading; it would appear that it might have brought charges for illegally rigging an entire market.

The case against Steinhardt was started under the senior Bush Administration, but a good part of the investigation and the settlement was worked out under the Clinton Administration. This raises the question of who might have blocked the responsible agencies—the DOJ and SEC—from bringing criminal charges against Steinhardt. The Gore forces in the Clinton Administration certainly didn't want the head and chief funder of the DLC, Steinhardt, to go to jail. *EIR* is investigating what role these forces might have played to keep Steinhardt out of jail.

In 1994, Steinhardt Management experienced losses. The Sept. 7, 1994 *Wall Street Journal* reported that in March 1994, Steinhardt's firm had suffered a $1 billion loss. In 1993, Steinhardt Management and the hedge funds it managed had more than $5 billion in capital, a significant sum for a hedge fund; by late 1994, Steinhardt Management and the hedge funds it managed had $2.7 billion, a fall of nearly half. In 1995, Steinhardt liquidated Steinhardt Management, and returned to investors that portion of the capital that was due them.