How Rudy Served as Midwife to Greenspan's 'Wall of Money' Policy

by Harley Schlanger

In the 1980s, the ambitious Rudy Giuliani built his reputation as a tough fighter in several high-profile prosecutions of New York City mob figures. However, it was his prosecution of Michael Milken, and his role in bringing down Drexel Burnham, Milken's junk bond fiefdom, which gave him an image as the protector of the people, who was looking out for the interests of the "little guy," against the newly rich predators of Wall Street, during the "era of greed."

The reality is quite different. Just as Rudy is really not a great counter-terror figure, his reputation as the defender of the little people against Wall Street is a fraud. In fact, his work on Wall Street served the purposes of the old establishment, in that he enabled them to dump Milken and Drexel Burnham, which had outlived their usefulness by 1987, and move on to the next phase of post-industrial, deregulated, free-market policies, under Federal Reserve chairman Alan Greenspan.

(How Drexel Burnham was used in the 1980s, under Michael Milken, is paralleled almost precisely by the role Enron played in the 1990s. Both served as battering rams against the old rules and the old order, then were put out of business, while the rule changes that led to their rapid growth, and transformed the way "business" was done, were kept in place, as the new paradigm.)

Rudy's 'Damascus Road' Conversion

When Rudy served as Associate Attorney General in the Reagan Administration, he expressed contempt for the prosecution of "white-collar" crimes, which he considered to be "anti-business." He said of such prosecutions under the Carter Administration, "The previous administration had one priority, and that was white-collar crime. I think there was almost a McCarthyism to it." He accused the U.S. Attorneys who were appointed by Carter of being "zealots rather than prosecutors." In June 1983, he was appointed U.S. Attorney for the Southern District of New York. After several lackluster years, he jumped on an insider trading scandal, to reinvent himself as an anti-corruption crusader.

The change occurred when Dennis Levine, managing director of Drexel Burnham Lambert, was arrested in May 1986, and charged with insider trading. Though Giuliani had nothing to do with making the case against Levine, he tried to take credit for it, proclaiming that he would use his office to clean up insider trading. His first big target was Ivan Boesky, an arbitrageur who was a financial hit man for Michael Milken—i.e., Milken would use Boesky in targeting companies for takeovers. Boesky's stock purchases, usually funded by Milken and his gang of slightly laundered money men for organized crime operations, would be used as a probe, to see if a company could be "put in play." Boesky was a criminal-prosecution-waiting-to-happen, as one writer later described him. In September 1986, using evidence provided by Levine, Rudy deployed a task force to go after Boesky. The SEC was already preparing a case against him. (At that time, Rudy was personally engaged in the political corruption trial of former Bronx Democratic Party leader Stanley Friedman.)

On Sept. 17, 1986, Boesky reached a settlement with the SEC. The criminal case was under the direction of Rudy's assistant, Charles Carberry, who met with lawyers at the offices of Fried, Frank, to negotiate a plea. On Nov. 14, 1986, Rudy went public with the plea agreement made with Boesky, who had agreed to be a government informant against Milken and Drexel. In February 1987, Rudy staged high-profile arrests of three top arbitrageurs, two from Kidder Peabody and one from Goldman Sachs. These were embarrassing for the firms, as the corporate officials were seen on the evening news being led out in handcuffs. Ultimately, these arrests turned out to be embarrassing for Rudy as well, as he had a difficult time getting the officials to agree to plea-bargain.

Targetting Drexel Burnham

Milken and Drexel were still flying high, doing huge deals, including high-profile corporate takeovers. Milken told his gang of insiders at his annual Predator's Ball, that they now had access to large enough sums to take over any corporation, even General Motors, if they wanted. The keys to Milken's operation were 1) access to large amounts of cash; 2) a deregulated banking climate, which included changes for Wall Street. One of the most significant of these was a ruling which allowed interest on the debt incurred in financing hostile takeovers to be taken as tax deductions—i.e., to use debt to lessen tax liabilities. Drexel had been one of the leading firms in lobbying for this deduction.

This ruling was a critical component in ensuring the flood of funds available for takeovers, as debt was no longer seen as a problem. In addition to his argument that high-yield bonds—so-called junk bonds—were really "fallen angels," and a good risk, the idea that debt is now an asset and not a liability was furthered by the Drexel/Milken operations.

Older firms now wanted to get in on the enormous profitability of the mergers and acquisitions (M&A) and leveraged buyout (LBO) deals. The Boesky case gave them an opportunity to bring down Milken and Drexel. The SEC, on Sept. 7, 1988, filed a lawsuit against Drexel, alleging that it was engaged in insider trading, and naming Milken as one of those under investigation.

Rudy immediately came charging in behind them. By December, he threatened to use RICO (Racketeer Influenced and Corrupt Organizations Act) charges against Drexel, unless they agreed to a plea bargain. They were reluctant. Rudy then used a trump card. In August 1988, he had used RICO charges against a Wall Street firm for the first time, in the Aug. 4, 1988 indictment of Princeton/Newport, a firm with ties to Milken. Princeton/Newport was essentially a hedge fund, using computer models to place bets. Rudy ordered a raid on its corporate offices, by 50 Federal agents, with bullet-proof vests and armed with automatic weapons. The raid shocked the company, and its investors, who pulled out their funds, leading Princeton/Newport to liquidate in December 1988. Rudy's assistant, Bruce Blair, reportedly told attorneys from Princeton/Newport that his office was not really interested in them, "but Princeton/Newport can help us with Drexel Burnham."

The threat that Drexel would be given the same treatment convinced its board members to capitulate, rather than face a racketeering indictment. On Dec. 21, 1988, Drexel pled guilty to six felony counts, and paid a $650 million fine. In return, Rudy dropped his pursuit of the RICO charges.

Throughout this period, there was a grand jury investigation, hearing evidence against Milken. Once Drexel had folded, Rudy again escalated. On March 29, 1989, the grand jury returned a 98-count indictment against Milken. Rudy proceeded to conduct a trial by press, in the attempt to get Milken to accept a plea. On Feb. 13, 1990, Drexel filed for bankruptcy. Rudy continued to escalate against Milken. He threatened to indict his younger brother. He leaked material to Laurie Cohen, a *Wall Street Journal* reporter, who wrote 18 stories about the prosecution case, full of false information and bluster from Rudy, including a story that he was planning to go for a superseding indictment with 160-180 counts. On April 24, 1990, Milken pled guilty to six counts.

Greenspan Steps In

While the Rudy versus Drexel/Milken battle was raging, two significant events occurred, which were part of the broader context.

First, was Black Monday, Oct. 19, 1987. In early October, the Dow Jones Average crossed over the 2,700 level for the first time, driven in large part by the speculative stock bubble fueled by Milken's takeover operations, in which corporate stock was purchased by hostile "raiders" at prices far above the stocks' listing. In reaction to this, there were rumors, first reported in the financial press on Oct. 14, that Congress might initiate legislation to limit the deductibility of interest incurred in these takeovers. This was a major disincentive for takeovers, and these rumors were blamed for cooling the takeover craze.

The Dow fell 100 points on Oct. 15, then another 100 on Oct. 16. The market then crashed on Monday, Oct. 19, just as Greenspan was taking over as chairman of the Federal Reserve. Greenspan reacted to Black Monday by opening the Fed, and pouring out money to Wall Street. This led to a renewed frenzy in M&A and LBOs, creating a new stock bubble, as records in M&A activity were set in the beginning of 1988, with Drexel continuing to be a key player—at least, until September.

The second major event was the takeover of Nabisco by the RJ Reynolds Tobacco Co., creating RJR Nabisco. When the smoke cleared on this LBO, the cost was more than $25 billion, and the stock of RJR had gone from approximately $35/share to more than $110. The takeover fight raged on in October and November of 1988, spilling over into early 1989—as the takedown of Drexel Burnham was proceeding.

The deal was closed on Feb. 9, 1989, with a cash payout of $18.9 billion. According to Burrough and Helyar in their book on this fiasco, *Barbarians at the Gates*, the "Federal Reserve couldn't wire money in amounts over $1 billion. . . . The flow was so big [to complete the takeover,] it made the U.S. money-supply statistics temporarily bulge. . . ."

The RJR Nabisco takeover was the last one utilizing this kind of cash payment. In the future—thanks in part to Wendy Gramm (head of the Commodity Futures Trading Commission, 1988-93, then a member of the board of directors of Enron; wife of former Texas Republican Sen. Phil Gramm), and her deregulation of derivatives—the awkwardness of coming up with large cash payments was replaced by "innovative" financing. Forty-eight days after the completion of the RJR Nabisco deal, Michael Milken was indicted, on March 29, 1989.

By then, Giuliani had left the U.S. Attorney's office, and he ran, unsuccessfully for Mayor of New York, an office he won four years later. Among the leading contributors to both campaigns were officials from the leading Wall Street firms, which benefitted most from the takedown of Milken and Drexel. The most generous donations were from officials from Dillon Read and Lazard Frères.