

## CHAPTER FOUR

# Following (or Harassing?) the Money



I think often of the prosecution of Michael Milken, the financial genius and guiding star of the brokerage firm of Drexel, Burnham & Lambert. Milken and his firm flowered in the 1970s and '80s when Milken created a whole new capital market capable of financing daring new ventures that threatened to upset many an old order. But the firm and its visionary leader suddenly crashed and burned at the climax of the Department of Justice's assault on the "decade of greed" in the late-1980s and early-'90s.

The case has gnawed at me, and not because I instinctively have more sympathy for my billionaire clients than for the penniless political radicals I've represented *pro bono*. Rather, the techniques used to force Milken to plead guilty to non-crimes were so raw and dangerous that it became obvious to me, shortly after I joined his defense team following Milken's unexpectedly harsh sentencing, that the same techniques would soon be applied to a much wider sphere of civil society which cannot afford to fight. The pain unjustly suffered by Milken and his family was real and palpable, and it became clear that if they can do this to him, they can—and will—do it to anyone.

Had Milken *not* been famous and wealthy, critics might have taken a closer and more dispassionate look at the fabricated case against him and the methods used to force him to plead guilty. As is so often the case with federal criminal prosecutions, the fabrication consisted, in part, of dubious testimony given by rewarded witnesses, and felony charges for conduct (admitted to by Milken) that, to informed and objective observers, did not appear to constitute crimes.

Michael Milken's pioneering development of higher-risk, higher-yield corporate bonds (dubbed "junk bonds" by his detractors) gave birth to some of the most important start-up (and, in a real sense, upstart) companies of the decade. Among these were such now well-known challengers to America's corporate status quo as McCaw Cellular, Barnes & Noble, MCI, and Ted Turner's Cable News Network (CNN). Any ambitious entrepreneur with more ideas than cash could urge Milken to convince his wide network of wealthy risk-takers to invest in an innovative enterprise in exchange for a higher-than-normal interest rate on the company's bonds, often combined with some stock option component (dubbed an "equity kicker") to make the investment more attractive should the company succeed. A number of his clients were money managers with great sums at their disposal, and they found that investing in Milken deals provided unusually hefty profits in return for risks that were only slightly more daring than more traditional investment vehicles. Milken's secret, if it was a secret at all, was that ventures deemed too risky by traditional banks and investment houses were in fact not all that perilous and offered the chance of substantially above-average returns, particularly as they revolutionized certain industries. He filled a gap and made him and his firm very rich. This did not go unnoticed by the envious nor the ambitious. All this restructuring infuriated elements of the corporate and investment-banking establishments, and it made Milken a target of opportunity for federal prosecutors.

Milken's problem was not simply that, in the go-go days of the '80s, prosecutors were overly sensitive to cries of "foul" by a business establishment unaccustomed to such ungentlemanly competition, or that the news media were particularly hungry for a good big-business scandal. Milken's biggest problem was that some of his most ingenious but entirely lawful maneuvers were viewed, by those who initially did not understand them, as felonious, precisely because they were novel—and often extremely profitable.

Drexel and Milken had been under investigation since the mid-1980s, and Milken received a "target" letter from the DOJ in September 1988 informing him that he was likely to be indicted. When the firm

was indicted and then pled guilty in December 1988, it was obvious that the shoe would drop on Milken, since the firm agreed, as part of its plea bargain, to “cooperate” in the government’s investigation of the firm’s erstwhile *wunderkind*. When Milken was finally indicted in March 1989, the DOJ told the nation, on the second page of its massive 110-page indictment, that the financier had earned \$45,715,000 in 1983, escalating each year until his “direct compensation” from Drexel reached \$550,054,000 in 1987. Many reporters, it seemed, barely had to read beyond this page to conclude that Milken *must* be guilty.

The indictment appeared to be the ordinary mishmash of counts under the usual statutes-of-choice. These included mail fraud, wire fraud, securities fraud, and, to make the parts appear to add up to more than the whole (and to enable the government to demand asset forfeiture), racketeering. There was, however, one aspect of the indictment that made it likely that this wealthy, headstrong, and self-confident titan would enter into a plea bargain rather than fight to the bitter end. Milken’s younger brother, Lowell, also was accused of being a key participant in his brother’s “fraudulent” schemes. Lowell had a decidedly secondary role in Drexel’s trading operations in comparison to Michael, but as the indictment was careful to point out, Lowell’s compensation, while not near that of his older brother, was hardly a pittance. His “direct compensation,” the indictment blared, had escalated from \$10,180,000 in 1984 to \$48,059,000 in 1987.

To knowledgeable observers, adding Lowell to the mix seemed diabolically calculated to pressure Michael to cut a deal rather than challenge the government’s claim that Milken’s Drexel deals were in any way criminal. (As one Milken lawyer put it, “if Lowell’s last name were Smith, he would not be in the case.”)<sup>1</sup> The inclusion of Lowell as a defendant lent a sense of unease to those who knew Michael well, for his public reputation as a finance whiz was exceeded by his private reputation as a deeply devoted family man. Michael, thought insiders, would not easily risk letting his younger brother go down the tubes. Lowell, for his part, put no pressure on his older brother to throw in the towel just to protect him.

The matter of Lowell Milken's being included in Michael's indictment, however, was on the back burner as long as a successful defense seemed feasible. And when the indictment was announced, the betting was that Milken would give the DOJ the legal fight of the decade, if not of the century. Rudolph W. Giuliani, who in 1983 began a spectacular five-year stint as the U.S. attorney for the Southern District of New York, had put together a team of tough, eager, and exceedingly ambitious (for themselves and their boss) prosecutors.<sup>2</sup> Giuliani's political ambitions were suggested by the fact that his group of lawyers and investigators, known as the "Yes Rudys!," included one tasked with tending to the boss's political future. As we now know, they did their job well. Giuliani would serve as mayor of New York for two terms (from 1994 to 2002) and would for a brief time be deemed a serious contender for the Republican nomination for president in the 2008 election.

Milken, for his part, assembled a legal team headed by the highly regarded Arthur Liman, lead litigator and legal strategist of the renowned New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison.<sup>3</sup> Milken's lifelong friend and personal attorney, Richard Sandler, was a stickler for detail and had command of an enormous body of facts.

Developments over the next few months made a vigorous defense to the palpably weak charges inadvisable, however. Milken's legal team learned that the DOJ was planning to bring a "superseding" indictment with expanded charges. When FBI agents interviewed Milken's 92-year-old grandfather, it was taken as a hint that the feds were trying to involve, or at least harass, other family members to put still more pressure on the family head to take a fall. And there was always the possibility that, as the investigations continued, the Milken brothers could be indicted yet again, even if they won this trial. More ominous still, there were noises about indictments in various states. The chances of winning against all (even unmerited) indictments naturally decreased as the number of jurisdictions expanded. The message to Michael was that unless he gave up the battle and delivered to the DOJ the victory it craved, both brothers could look forward to a long stretch of trials that, statistically, would make a conviction somewhere along the line more than likely, followed by very lengthy sentences.

Finally, after using a host of bare-knuckled tactics to discourage Milken from testing its dubious criminal indictment, the government made the older brother an offer he could not refuse: if Michael would plead guilty to six felony counts and agree to pay \$600 million, the feds would drop all charges against Lowell. Further, while a routine obligation to “cooperate” with the investigations and prosecutions would ordinarily be included in the plea bargain, Milken would not be obligated to give the feds any information in advance or to compose a script for testimony in any particular case. The plea agreement was unusual for another reason as well: the government agreed not to recommend any particular sentence to the judge.

The proposed deal did not do violence to Milken’s conscience. He would not have to “sing” (or, worse, to “compose”) incriminating testimony against friends and colleagues, as so many “cooperators” find themselves pressured to do. And so, to save everyone, especially his younger brother, Michael agreed to the plea bargain.

The six counts involved what appeared at first glance to be a garden variety of securities and tax fraud transactions. Three of the counts involved dealings with the infamous Ivan Boesky, a fraud artist and former Drexel client who made a pact with the feds to avoid a substantially longer sentence. These counts involved a securities industry practice known as “stock parking,” which was never defined in federal law or regulations as a crime, and which was quite common in the industry. Two other counts involved transactions that Milken engaged in with David Solomon, a funds manager who likewise had turned government witness. The sixth count was merely a conspiracy charge covering the events in the first five.

While the entire world seemed to assume that Milken had confessed to actual crimes, a few recognized that the DOJ emperor actually had no clothes. At the time, *The Wall Street Journal* opinion writer L. Gordon Crovitz penned column after column questioning how and why the transactions constituted crimes. After the case was over, former University of Chicago Law School Dean and economist Daniel Fischel analyzed the case in a highly regarded 1995 book called *Payback*.

Fischel concluded that the six counts, and indeed the entire original indictment, described perfectly lawful transactions that required a huge stretch to be even remotely considered criminal.<sup>4</sup>

Yet at the time of his plea, neither Milken nor his attorneys publicly questioned the felony charges. After he had agreed to plead guilty, it was suddenly in his interest to see his plea accepted by Judge Kimba Wood of the U.S. District Court in Manhattan. If Milken questioned the charges, the judge would not accept his plea on the six counts and he would be forced to go to trial on the entire indictment. Giuliani got precisely what he wanted.

Immediately after Milken's lawyers announced his plea agreement in open court, in April of 1990, SEC Chairman Richard Breeden held a press conference to put to rest suspicions bruited about by the likes of journalist Crovitz: "Mr. Milken has been portrayed as wrongly accused and as having simply devoted himself to the financing of small or emerging businesses," announced Breeden. "His admissions today demonstrate that he stood at the center of a network of manipulation, fraud, and deceit." The skeptics were consigned, for the moment, to retreat.

As Milken's sentencing approached, the case went a bit off track. Pre-sentencing maneuverings began when DOJ lead prosecutors John Carroll and Jess Fardella filed a memorandum with Judge Wood that seemed to violate the spirit, if not quite the letter, of the agreement that the government would not make a sentencing recommendation. It claimed to describe "Milken's Other Crimes" and went on to ask that "Milken be sentenced to a period of incarceration that reflects the enormity of his crimes."

Judge Wood decided to hold a hearing on sentencing. At the hearing the government would be given 20 hours to present its evidence and arguments on its three strongest "other crimes," and the defense would have an opportunity to contest those claims. Milken's lawyers could not really argue that he had pleaded guilty to non-crimes, even if they believed such to be true, for that would wreck the plea bargain. But

they were entirely free to contest the government's claim that "other crimes" had been committed. The sentencing hearing was set to become the first public clash between prosecutors and Milken's lawyers over whether Milken was the white collar criminal of the century.

Knowledgeable observers recognized that the government's courtroom presentation, in the fall of 1990, was a total bust. The definitive proof came when Judge Wood made her sentencing decision, saying she would not rely on the "other crimes" allegations because "the evidence established neither the government's version of Milken's conduct nor Milken's own version." It was perhaps too much to expect that, at this tense and highly visible stage of the case, Judge Wood would do a 180-degree turn and begin questioning the basis for Milken's plea to the six felonies. And, after all, she was not yet sure that Milken's protestations of innocence of the "other crimes" were entirely correct. But surely the government had taken its best shot and missed. Nonetheless, Judge Wood imposed an unexpectedly harsh ten-year prison sentence, in part because she believed that Milken "engaged in the additional misconduct of attempting to obstruct justice." This impression seemed to be based on testimony offered by former Drexel employees, now cooperating witnesses, that Milken acted secretly in the run-up to the investigation. In one typical bit of testimony, a Drexel underling recounted a meeting during which Milken didn't speak and instead communicated by writing notes on a pad and then deleting them. It is crucial to note that none of these witnesses ever actually testified that Milken instructed them to destroy documents, and the government apparently did not have enough confidence in these accusations to actually list obstruction of justice as one of Milken's supposed other crimes. Judge Wood's focus on these accusations was a bizarre and unexpected development.

At this point, Milken decided to ask a new set of lawyers to examine his plea. He hired Harvard Law Professor Alan Dershowitz, who in turn brought my law firm into the case. We did a close analysis of all six counts to which Milken had pleaded guilty and concluded—somewhat to our surprise—that he had pleaded guilty to six non-crimes. The le-

gal team suspected that Judge Wood imposed the overly harsh sentence in part due to inexperience (President Reagan had nominated her to the federal bench in 1988) and in part out of a sense that she should not be seen as “weak” in the face of what prosecutors and the news media had labeled the largest securities fraud of the century. Perhaps she simply didn’t fully understand some of the complexities of the transactions involved. She was also known to be sensitive to the news media (at the time she was married to an editor at *Time* magazine) and did not want to endure the “soft on white collar crime” label. The defense aimed to have the judge reconsider in a more rational, less tense moment.

The plan worked. Milken, in an effort to get Judge Wood to lower the sentence, agreed to testify in a prosecution of former Drexel Burnham Lambert colleague Alan Rosenthal. What prosecutors perhaps had not counted on was that Milken would deliver truthful and unvarnished testimony that would help, rather than hurt, Rosenthal.

Rosenthal had been an employee of the Drexel firm who worked with Milken on various deals, including the deal resulting in one of the six counts to which Milken had pleaded guilty. The charge, which was tried before highly regarded federal District Judge Louis Stanton, claimed that Milken and Rosenthal had organized a scheme favoring a Milken client, David Solomon, involving certain tax trades that produced tax losses. The government claimed the trades were shams and the losses illusory because Milken promised he would find Solomon a profitable investment at some point in the future, in order to reimburse him for the losses. (For tax purposes, losses for which an investor is guaranteed reimbursement are not real losses.)<sup>5</sup> Solomon had been granted immunity from prosecution and then was enlisted as a government witness against Milken.

Losses for purposes of taking a tax deduction must be “real” rather than “sham” losses. The government deemed Solomon’s losses to be a sham because Milken had promised to find Solomon a favorable investment to make up for the loss. But this is not the same as a *guarantee* against loss. Contrary to the government’s contention, Solomon



undertook a real risk of loss. Milken could not argue the point in his plea bargain, as he was desperate to have Judge Wood accept his plea and his contrition. But neither Rosenthal nor Judge Stanton were in a similarly compromised position. Judge Stanton concluded that the tax losses were real, not illusory, and that Milken's promise to make up the losses by putting Rosenthal into profitable investments was a contingent, indefinite promise that did not render the tax losses illusory. Solomon, ruled Judge Stanton, was exposed to real economic risk, and the transaction was neither a sham nor a fraud.

Judge Stanton acquitted Rosenthal of that count and did not allow it to go to the jury. As for the remaining counts, the jury convicted Rosenthal of only a single minor charge, on which Judge Stanton imposed a probationary sentence. In other words, Judge Stanton found that the transaction from which the major charge against Rosenthal arose, the same "fraudulent" transaction to which Milken had earlier pleaded guilty and been sentenced to prison by Judge Wood, was perfectly lawful. Judge Stanton said from the bench that he understood how odd it was that he was acquitting Rosenthal on a count to which Milken had pleaded guilty. "I make this ruling in the full understanding of the anomaly that those persons who participated in it and have testified thought it was unlawful," he noted. But the judge did his duty under the law.<sup>6</sup>

Because Milken appeared to have testified honestly rather than "cooperatively" and therefore failed to incriminate Rosenthal, there was a widely shared assumption that Judge Wood would not reduce Milken's sentence.<sup>7</sup> However, fooled once, Judge Wood was not about to be fooled again. On August 5, 1992, perhaps contrite from her involvement in perpetrating the myth that Milken was a criminal, Judge Wood reduced his sentence on the basis of his "substantial cooperation" with the government (which got no one convicted) to two years. He was released in March of the following year.



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- <sup>1</sup>. Telephone Interview with a Milken attorney, who requested anonymity (June 2007).
- <sup>2</sup>. Michael Powell, "A Crime Buster, With his Eye on the Future," *The New York Times*, December 10, 2007.
- <sup>3</sup>. Liman's predecessor as Milken's lead counsel was the legendary and considerably scrappier Washington lawyer Edward Bennett Williams, who died of cancer before Milken was indicted.
- <sup>4</sup>. Daniel Fischel, *Payback: The Conspiracy to Destroy Michael Milken and His Financial Revolution* (New York: HarperBusiness, 1955). Material and analyses from Professor Fischel's book have proven invaluable in corroborating and supplementing portions of this chapter.
- <sup>5</sup>. Roughly, here is how the "scheme" worked: Solomon in 1985 asked Milken and Rosenthal if Drexel could assist him in obtaining short-term capital losses that he could use on his tax return for that year to offset gains in his account. The type of transaction suggested would have the effect of delaying any tax due by one year. (Wage earners pay income tax on their annual earnings. Investors, on the other hand, pay capital gains taxes on profits realized from the sale of their investments. If a sale is made within a short period of time from the date of purchase, it is considered a "short-term capital gain" and subject to a higher tax rate. In contrast, if the investment is held longer, the tax rate is that for "long-term capital gains," which is lower.) Since the transaction involved an actual loss, Milken promised Solomon that he would keep Solomon in mind when a good investment came up in the following year. That way, Solomon could make up the loss. And since the "make up" investment, if held for more than six months, would produce a long-term capital gain, it would be taxed at a lower rate than either ordinary income or a short-term capital gain.
- <sup>6</sup>. Editorial, "Explanation in Order," *The Wall Street Journal*, June 12, 1992.
- <sup>7</sup>. Ronald Sullivan, "Former Protégé of Milken Convicted for a Kickback," *The New York Times*, June 11 1992 ("Lawyers on both sides said Mr. Milken, who is eligible for parole in 25 months, did not greatly help his chances of reducing his term because his testimony was seen as helping as much as hurting Mr. Rosenthal.").