

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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UNITED STATES OF AMERICA,
 Plaintiff,
 - v -
STEINHARDT MANAGEMENT COMPANY,
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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94 Civ. 9044

Filed: December 16, 1994

COMPLAINT

The United States of America, plaintiff, by its attorneys, acting under the direction of the Attorney General of the United States, brings this civil action to obtain equitable and other relief against the defendant entities and to obtain forfeiture of the defendant property and complains and alleges:

I. JURISDICTION AND VENUE

1. This action is brought under Sections 4 and 6 of the Sherman Act, 15 U.S.C. §§ 4, 6, as amended, to restrain violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, as amended, and to obtain forfeiture of property owned pursuant to a contract, combination or conspiracy in violation of Section 1 of the Sherman Act. The Court has jurisdiction over this matter pursuant to Section 4 of the Sherman Act and 28 U.S.C. §§ 1345, 1355.

2. Venue is proper in this district under Section 12 of the Clayton Act, 15 U.S.C. § 22, as amended, and under 28 U.S.C. §1391(c) because the defendant entities transact business and are found in the Southern District of New York.

3. This is an in rem proceeding against the defendant property. That property is in the defendant entities' bank accounts in the Southern District of New York.

II. DESCRIPTION OF THE CONSPIRACY

4. This action arises from an unlawful combination and conspiracy among the defendant entities, Steinhardt Management Company ("SMC") and Caxton Corporation ("Caxton"), and other persons, to restrain interstate trade and foreign commerce in the 7.00% United States Treasury notes auctioned on April 24, 1991 ("April notes") by withholding the notes from the markets for such securities in order to profit from the artificial shortage, or "squeeze," resulting from the withholding of supply.

5. Beginning in mid-April 1991, Caxton and SMC each bought large, leveraged long positions in the April notes. As of mid-May 1991, their combined position in the issue was almost \$20 billion. This combined position represented about 160% of the approximately \$12 billion of April notes issued by the United States Treasury. Between early May 1991 and mid-September 1991, SMC and Caxton, in combination, owned ("held") from \$12 billion to \$19 billion April notes.

6. The purchases of April notes by Caxton and SMC had the effect of concentrating ownership of the issue and, simultaneously, creating a substantial "short" position in it. Once created, this short position could be eliminated only if the defendant entities reduced the size of their positions in the April notes.

7. Caxton and SMC effectively controlled the supply of April notes available to both the "cash market" (where purchases and sales occur) and the "financing market" (where persons with leveraged long positions, such as the defendant entities, borrow money in order to buy or to continue to hold an issue). Short sellers in both markets were required, in effect, to buy or borrow April notes from Caxton or SMC.

8. After accumulating their position in the April notes, the defendant entities and their coconspirators acted to restrict the supply of April notes to short sellers. The consequence of this action was to cause short sellers to bid up prices for April notes in the cash and financing markets. From the latter part of

May 1991 through mid-September 1991, Caxton and SMC and their coconspirators withheld significant quantities of April notes from the cash and financing markets. Due to this constriction in supply, the price of April notes in the cash market was increased; likewise, interest rates charged to finance a position in the April notes were depressed.

9. As a result of the actions taken by the defendant entities and their coconspirators, they and their coconspirators earned substantial profits from the low financing rates and high cash prices of the April notes caused by their actions.

III. DEFENDANTS

10. SMC is a New York corporation with its principal place of business in New York, New York. SMC manages several investment funds. As manager of those funds, SMC purchased and financed April notes. SMC is the real party in interest related to the \$12,500,000.00 of defendant property it owns and controls.

11. Caxton is a Delaware corporation, with its principal place of business in New York, New York. Caxton manages several investment funds. As manager of those funds, Caxton purchased and financed April notes. Caxton is the real party in interest related to the \$12,500,000.00 of defendant property it owns and controls.

12. The investment funds SMC and Caxton manage compete with numerous investors and traders in the sale, purchase, financing

and lending of specific issues of United States Treasury securities.

13. Various persons not made defendants in this action have participated as co-conspirators in the violations alleged in this Complaint and have performed acts and made statements in furtherance of the conspiracy.

IV. THE MARKETS FOR APRIL NOTES

14. When the owner of a specific Treasury security holds a position in that issue that exceeds the amount of the issue available for purchase by short sellers in the cash or financing markets, a "squeeze" can occur. A squeeze is especially likely to succeed if the size of the position held by the single owner, or the combined position of the coordinating holders, exceeds the amount of the issue available to cover short positions through repurchase or "repo" agreements in the financing market. When a squeeze occurs, short sellers are required to pay abnormally high prices or to incur abnormally high financing costs to buy or borrow the specific security they are short.

15. Purchasers of Treasury securities that wish to leverage their investments, such as the defendant entities, usually finance their positions in the financing market. In a financing market transaction, the owner of a security sells the issue and simultaneously agrees to repurchase it on a specified date for a specified price. The repurchase price is higher than the sale price, the difference between the two prices representing an

interest rate, called the "repo rate". A financing market transaction is the functional equivalent of a loan in which Treasury securities are used as collateral.

16. Short sellers (traders who sell securities they do not own in the expectation that the price will fall) must purchase or borrow the specific security that they are obligated to deliver in order to fulfill their obligations. An investor who needs to borrow a specific Treasury security issue can do so in the financing market, through "special" repo transactions in which the investor (short seller), in effect, lends cash in exchange for collateral of a specific issue.

17. There are separate product markets within the meaning of the antitrust laws for specific Treasury issues within both the cash and financing markets. Some traders speculate in the financing market for specific issues, lending cash and accepting securities as collateral, in the hope that they can re-lend the collateral to someone else at a profit. Interest rates for special repo transactions in the financing markets fluctuate widely because they reflect supply and demand for a particular security. If a security is in short supply, the repo rate for that issue will generally be low because owners will be able to negotiate lower repo rates from short sellers competing to borrow the scarce security.

18. Prices in the cash and financing markets are related. When it is costly to borrow a specific security, demand for it in the cash market will increase if some traders buy, rather than

borrow, it. As a result, the issue may cost more than other securities of comparable maturity. Similarly, a high price in the cash market (compared to securities of like maturity) may cause short sellers to borrow a security through repurchase agreements rather than buy it. That increased demand may depress repo rates. The holder of a specific issue can earn a premium when lending or selling that security when demand for it is great in either the cash or financing market.

19. The owner of a large position in a specific issue, or two or more holders acting together, can limit the supply of that issue available to the specials market by financing all or part of their positions "off the street," that is, with parties who will not re-lend the securities. Such a restriction of supply can precipitate a squeeze when demand for the issue exceeds the supply made available. In that situation, investors who must borrow the issue must accept very low interest rates in the repo market (on the cash they lend to obtain the issue), enabling the owner or owners of the issue to earn a premium for making the security available.

20. Sellers of Treasury securities transmit securities to buyers in interstate commerce through the Federal Reserve System. The business activities of the defendant entities and co-conspirators that are the subject of this complaint were within the flow of, and substantially affected, interstate trade and commerce.

V. THE CONSPIRACY

21. Beginning in or about April 1991, Caxton and SMC agreed to acquire control of the supply of April notes and to limit the supply of April notes to the cash and financing markets in order to cause a squeeze and to profit thereby. To achieve the objectives of the conspiracy, the defendant entities did the things they agreed to do, including:

- a. purchasing and holding extremely large long positions in the April notes;
- b. exchanging information about their positions in the April notes;
- c. discussing ways to finance their positions in the April notes in a manner that would restrict the supply of the notes available to the cash and financing markets;
- d. restricting the supply of April notes available for specials transactions, beginning on May 23, 1991;
- e. instructing a primary dealer at which SMC concentrated the financing of its April note position to make the notes available for specials transactions only if the repo rate was below a specified level (and giving other directions to constrict supply availability);
- f. placing a part of Caxton's position in the April notes with a primary dealer that Caxton understood would place the notes with investors who were not likely to lend them;

- g. concentrating the financing of their positions with a single dealer; and
- h. continuing to hold their positions in the April notes at times when they could have sold some or all of these positions at a substantial premium.

22. As a result of the conspiracy, repo rates for the April notes in the financing market declined and cash market prices for the notes increased. Repo rates for April notes generally remained low and cash market prices high until September 1991, when the joint position of SMC and Caxton fell below the amount necessary to continue the squeeze.

VI. ANTICOMPETITIVE EFFECTS OF THE CONSPIRACY

23. The combination and conspiracy to restrain interstate trade and commerce in April notes had, among other things, the following effects:

- a. SMC and Caxton obtained market power over the April notes;
- b. Persons who sold April notes short were denied the benefits of free and open competition in the cash and financing markets for April notes, resulting in higher costs to finance and purchase April notes;
- c. Price competition for April notes was unreasonably restrained;

- d. Liquidity in the markets for April notes was reduced; and
- e. The Treasury was denied the benefits of a free and competitive secondary market for April notes.

24. The combination and conspiracy affected a substantial amount of interstate commerce and is likely to recur unless it is enjoined by this Court.

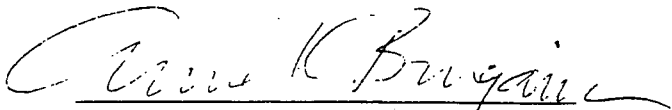
VII. PRAYER FOR RELIEF

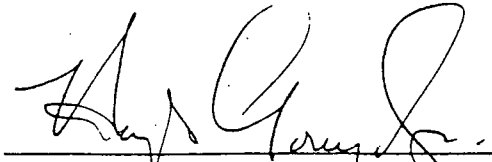
WHEREFORE, PLAINTIFF PRAYS FOR RELIEF AS FOLLOWS:

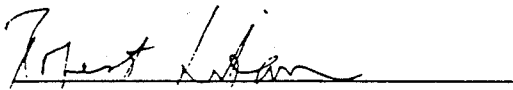
1. That the Court adjudge and decree that SMC and Caxton have combined and conspired in unreasonable restraint of interstate trade and commerce in April notes, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1.
2. That SMC and Caxton and all persons acting on behalf of either of them or under their direction or control be permanently enjoined from engaging in, carrying out, renewing, or attempting to engage in, carry out, or renew, any contracts, agreements, practices, or understandings in violation of the Sherman Act.
3. That the defendant property be forfeited to the United States.
4. That plaintiff have such other relief as the Court may consider necessary or appropriate.

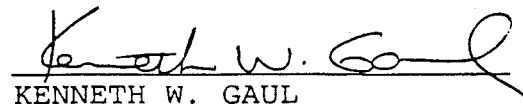
5. That plaintiff recover the costs of this action.

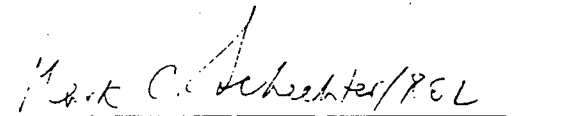
Dated:



ANNE K. BINGAMAN
Assistant Attorney General

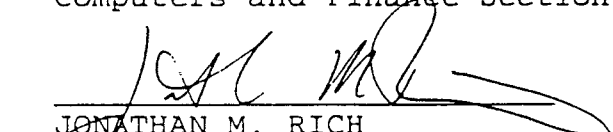

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