

THOUGHT CONTAGIONS

Resistance is Not Futile

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Donald Luskin

In the war on capitalism, the Microsoft decision was an important victory for the capitalists -- because it shows that victory is possible.

Today's war on capitalism began in when the **Securities and Exchange Commission** filed securities fraud charges against **Drexel Burnham Lambert** and its superstar investment banker **Michael Milken** in September, 1988. Threatening Drexel with ruination by criminal prosecution under the Racketeer-Influenced and Corrupt Organization Act (RICO) originally enacted for fighting the Mafia, **US Attorney Rudolph Giuliani** forced Drexel to plead guilty to six felony counts, pay a \$650 million fine, and fire Milken. In February 1990, Drexel declared bankruptcy.

Milken was indicted under in March 1989, and pleaded guilty in April 1990 to six felony counts. He paid a \$600 million fine under a plea bargain that promised him no jail time. In November 1990 judge **Kimba Wood** sentenced him to 10 years, plea bargain or no plea bargain. But Milken never got his \$600 million back. And three years later Rudolph Giuliani was elected mayor of New York City.

Milken and Drexel -- for all their wealth and power -- bet that resistance was futile, and opted to go along to get along. And they lost everything. But the lesson learned from this by today's corporate executives whose companies face the prospect of criminal prosecution has *not* been that capitulation leads to disaster -- it's that Milken and Drexel just didn't capitulate *soon enough*.

But now there's alternative lesson out there -- it will be interesting to see if it's a thought contagion that can spread. A decade after the fall of Milken and Drexel, a capitalist even more spectacularly successful than Milken -- **Bill Gates** -- dared to resist. And last Friday, *he won*.

On May 16, 1998, Gates walked away from negotiations with the **US Department of Justice's Antitrust Division** and the attorneys general of 20 states to prevent the threatened filing of a sweeping antitrust suit against **Microsoft**. Gates had offered many concessions in the spirit of compromise, but he refused to accede to the demand that Microsoft agree to distribute the software of its archrival **Netscape**.

Since then the Dow Jones Industrial average has fallen 5.6%. The S&P 500 Index has fallen 18.1%. And the NASDAQ Composite has fallen 24.4%. But the stock of Microsoft is up 30.9%. Netscape is no more. And on Friday judge **Colleen Kollar-Kettely** approved a settlement that leaves Microsoft very much intact -- over the strident objections of nine states' attorneys general seeking far harsher penalties and structural remedies.

Kollar-Kettely rejected the scorched-earth approach of these attorneys general, rebuking them for dragging in "all existing allegations of anticompetitive conduct -- which have not been proven or for which liability has not been ascribed." She added, "Equitable relief in an antitrust case

should not 'embody harsh measures when less severe ones will do,' nor should it adopt overly regulatory requirements which involve the judiciary in the intricacies of business management."

The market celebrated Microsoft's victory yesterday, as well it might. In the war on capitalism it was an important victory for the capitalists. But its meaning is not that it sets powerful pro-capitalist precedents that will be used in other trials in the future, or that it signals a U-turn in antitrust activism back toward the *laissez-faire* approach of the **Ronald Reagan** years. It does neither of those things. Its meaning is simply that victory *is* possible. You *can* fight the power. Resistance is *not* futile.

That may not sound like much. Sure, there are lots of things that would better -- such as if **US Attorney General John Ashcroft** fired all the **Clinton**-era antitrust zealots who still dominate the DOJ, or if **Congress** passed a law limiting the role of states attorneys general in federal antitrust and securities prosecutions (or, best of all, if **Elliot Spitzer** would fall into an open manhole).

But don't fail to recognize the subtle but important power of a shift, at the margin, in the game theory calculus of the combatants in the war on capitalism. If corporate defendants begin to factor into their strategies that they just might win -- and if regulators and especially state attorneys general begin to factor into *their* strategies that *they* just might *lose* -- perhaps capitalists won't be in such a hurry to march themselves into the gas chamber at the first threat of prosecution.

We've pointed out frequently in client reports that the economy and the capital markets are seized in a spasm of risk aversion, and that meaningful recovery won't be possible until that spasm is relaxed. And now one of the worst risks is that, at any moment, any company or industry may be the next one to get hit by some allegation of criminal wrongdoing -- allegations that have been seen as both catastrophic and impossible to defend against. Investors today have come to feel that holding stocks is like drinking in a speakeasy during the Prohibition -- one eye is always on the newswire looking for the story that shouts "*Cheese it! The cops!*"

If corporate executives, at the margin, become less risk averse about defending their companies against regulatory assaults -- and if, at the same time, regulators and state attorneys general become slightly *more* risk averse about launching scorched-earth prosecutions -- then the risk of catastrophic police raids is reduced. Perhaps that's enough to allow the absorption of a little more of the enormous risk premium still baked into today's deeply undervalued equity markets.

Yesterday it was enough to knock the major indices up and out of their trading ranges of the last three weeks. The markets closed off their best levels when more immediate concerns intervened, but who knows...? We're not altering our [Model Position in equities](#) because of it, but if the idea that resistance is not futile spreads a little, the breakout may even last. **TM**