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Common Themes in Designs of Public Institutions for Fostering Innovation, Competition, and Finance

F. Scott Kieff
United States International Trade Commission
George Washington University (on leave)

Troy A. Paredes

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Common Themes in Designs of Public Institutions for Fostering Innovation, Competition, and Finance

By
F. Scott Kieff and Troy A. Paredes[1]

ABSTRACT

This paper provides concrete examples of the themes that emerge from a review of the detailed design and implementation of particular legal systems (public institutions) intended to foster innovation, competition, and finance, such as intellectual property, antitrust, and securities regulation. Using basic tools from the fields of economics and political science the paper highlights particular examples of key incentives and constraints that are acting upon the individuals and organizations in both the market and government sectors within current systems. It then takes seriously the goals usually articulated with significant consensus in public policy debates about those public institutions, particularly during debates about their reform. In so doing, it elucidates contrasting approaches to the design of representative institutions in these fields to highlight some basic themes in the way the legal rules are implemented with an eye towards the impacts they tend to have in the real world. Particular attention is paid towards understanding reasons why for certain common themes in the design of these institutions, stated policy goals may not be well served and risk of significant collateral costs may be especially high.

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[1] This paper was prepared for, and first presented at, the January 31, 2014, conference on Patents and the Innovation Economy hosted by the Working Group on Intellectual Property, Innovation, and Prosperity (IP^2) at Stanford University's Hoover Institution, directed by Stephen H. Haber. The authors gratefully acknowledge the many helpful contributions from conference participants, including especially those of discussant Manuel Jose Molano Ruiz. Kieff is on leave from his post as Fred C. Stevenson Research Professor of Law at The George Washington University while serving as Commissioner at the U.S. International Trade Commission (ITC). He began work on this paper before he took up his government post on October 18, 2013. At that time he was Ray & Louise Knowles Senior Fellow at Stanford University's Hoover Institution, where he co-founded and co-directed with Haber and Paredes Hoover's Project on Commercializing Innovation, of which the IP^2 Working Group is the successors. Paredes has been Professor of Law and Business (by courtesy) at Washington University in St. Louis. From August 1, 2008 until August 3, 2013, Paredes served as Commissioner at the U.S. Securities and Exchange Commission (SEC). Paredes commenced work on this paper after leaving the SEC. The views expressed herein are not properly attributable to the ITC, the SEC, or any of their other Members or Staff.

I. INTRODUCTION

In the social sciences, the term "institutions" refers to constraints that are human imposed—laws, rules, norms, and their enforcement characteristics. The fields of New Institutional Social Sciences and New Institutional Economics study the nature and degree of the impact that different institutions can have on overall economic and social performance.[2] Institutions are usually considered to be largely endogenous to a given democratic society—meaning that they are seen as internally generated rather than imposed from outside—because it is generally at least some subset of the people in that society that decides which institutions are implemented.[3]

When the institutions operate at the level of a particular private group of individuals and businesses, they generally are referred to as private institutions, or private ordering, such as the way reputation and repeated interactions can modulate behavior, or the norms and rules adopted by communities such as trade associations and standard setting organizations. When the institutions operate at a larger level, usually involving particular formal involvement of government, they generally are referred to as public institutions.

This paper considers the design, development, and impact of select institutional features of key legal and regulatory regimes relating to innovation, including intellectual property (IP) law, focusing on one of its key components, patent law, antitrust law (also often referred to as competition law), and securities regulation. Given the complexity and thoroughness of these regimes, this paper is not exhaustive. Rather, it merely highlights some of the important differences in the way particular approaches to design and implementation of public institutions in these fields can impact the likelihood of accomplishing the stated goals of a particular institutional arrangement and the likelihood of triggering various deleterious side effects that can undercut what is sought to be achieved.[4]

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[2] *See* F. Scott Kieff, *Coordination, Property, and Intellectual Property: An Unconventional Approach to Anticompetitive Effects and Downstream Access*, 56 EMORY L.J. 327, 338–40 (2006); and Henry E. Smith, *Institutions and Indirectness in Intellectual Property*, 157 U. PA. L. REV. 2083, 2083–101 (2009).

[3] *See* Stanley L. Engerman & Kenneth L. Sokoloff, *Debating the Role of Institutions in Political and Economic Development: Theory, History, and Findings*, 11 ANN. REV. POL. SCI. 119, 124–25 (2008) (discussing the definition of "institutions" and their endogenous and exogenous origins). Of course, sometimes laws can be imposed by outside forces, such as when a society is controlled by a foreign power. For more on endogenous institutions, see *id.*

[4] To some extent, these deleterious side effects often are appropriately considered to be unintended consequences. At the same time, broad understandings of organizational psychology suggest that whatever a group is doing usually does reflect, to at least some extent, intentions that actually are present within the group and in that sense would not fairly be characterized as unintended. Furthermore, broad understandings of political science suggest that often what a group does (such as the laws passed or enforced within a

II. A PATENT SYSTEM'S BASIC GOALS & ENFORCEMENT PROCEDURES

The discussion in this Part highlights some basic differences in the types of goals a society might set for its patent system and the types of dispute resolution procedures that might be used within such a system. In so doing, the discussion explores some ways in which tacking in different directions on choices about goals and dispute resolution procedures can have predictably different impacts on innovation, including public access to its fruits and competition in its commercialization.

There turns out to be important differences in the way people envision the main goal of the patent system. Although many commentators and policy makers see patents as tools that societies use to encourage inventors to invent, significant and politically diverse voices among those studying and implementing the U.S. patent system have instead focused on the role of strong and predictable rules for patent procurement and enforcement in facilitating competition and the commercialization of inventions.[5] One key difference between these views about the core goal of a patent system lies in who is the target: inventors in particular or a diverse set of market actors in general. Another key difference lies in the mechanism contemplated to stimulate the behavior of the particular target.

Economic history has taught that a defining feature of the early U.S. patent system that was central to its economic success was the way in which it used a property rights approach to facilitate private ordering.[6] Analysis of legal history reveals that one of the two principal drafters (Giles S. Rich) of the statute that implemented the patent system that operated in the United States from 1952 through the end of the twentieth century was explicit in focusing on the role of patents in facilitating coordination among many diverse market participants in order to commercialize innovation, rather than on getting inventions made.[7] As Abraham Lincoln described it, the patent system "added the fuel of

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larger society) is the product of a complex interaction among the relative power and intensity of preferences of particular individuals and sub-groups within the larger whole and therefore typically well reflect the intentions of some members while being unintended, if not even disliked, with respect others.

[5] B. Zorina Khan & Kenneth L. Sokoloff, *History Lessons: The Early Development of Intellectual Property Institutions in the United States*, J. ECON. PERSP., Summer 2001, at 233, 235.

[6] *See*, *e.g.*, Naomi R. Lamoreaux & Kenneth L. Sokoloff, *Intermediaries in the U.S. Market for Technology, 1870–1920*, *in* FINANCE, INTERMEDIARIES, AND ECONOMIC DEVELOPMENT 209, 210–11 (Stanley L. Engerman et al. eds., 2003); Khan & Sokoloff, *supra* note 5, at 235.

[7] *See* Giles S. Rich, *The Relation Between Patent Practices and the Anti-Monopoly Laws*, 24 J. PAT. & TRADEMARK OFF. SOC'Y 159 (1942), *reprinted in* 14 FED. CIR. B.J. at pages 5, 21, 37, 67, and 87 (2004-2005) (2004-5) (five-part series of articles). The other principle drafter, who also wrote a great deal about the statute, was Pat Federico. Leading jurists of commercial law from diverse political perspectives immediately recognized the power of the 1952 Act in strengthening patents and having championed strong patents as tools for helping

interest to the fire of genius, in the discovery *and production* of new and useful things."[8] As shown through analysis of legal history, this approach to strong patents has enjoyed support across the U.S. political spectrum.[9]

While the different focus on targeting inventors to stimulate them to make inventions has much appeal, the difference between the goals of inventing and commercializing reveals some key institutional features of the patent system. Consider that the goal of getting inventions made generally involves the use of targeted incentives that can be provided by a host of alternatives to patents, such as tax credits, prizes, grants, rewards, and the like.[10] Providing these targeted incentives requires an immense amount of information about who exactly should be targeted and how large the incentive should be, and those operating under the regime have stronger incentives to seek their own rewards than to discipline the giver to be more frugal in giving rewards to others.[11] Not only is amassing all of that information hard for the government to do, but it is likely that large,

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smaller market entrants compete against larger, established firms. *See* Reiner v. I. Leon Co., 285 F.2d 501, 503 (2d Cir. 1960)(Hand, J.) ("There can be no doubt that the Act of 1952 meant to change the slow but steady drift of judicial decision that had been hostile to patents . . . ."); Picard v. United Aircraft Corp., 128 F.2d 632, 643 (2d Cir. 1942) (Frank, J., concurring) (discussing the role of predictable rules for patent enforcement in helping a smaller "David" compete with a larger "Goliath").

[8] Abraham Lincoln, Second Lecture on Discoveries and Inventions (Feb. 11, 1859), *in* 3 THE COLLECTED WORKS OF ABRAHAM LINCOLN 356, 363 (Roy P. Basler ed., 1953) (emphasis added and omitted).

[9] *See, e.g.*, Judge Pauline Newman, *Foreword: The Federal Circuit in Perspective*, 54 AM. U. L. REV. 821, 822–23 (2005) (reviewing history of the 1982 statute designed to strengthen the U.S. patent system and included as a major domestic policy initiative of the Carter Administration before being signed into law by the Reagan Administration); *see also* Federal Courts Improvement Act of 1982, Pub. L. No. 97-164, 96 Stat. 25 (codified as amended at 28 U.S.C. § 171) (creating the U.S. Court of Federal Claims); The Indus. Advisory Subcomm. on Patent & Info. Policy, Report on Patent Policy, *in* ADVISORY COMMITTEE ON INDUSTRIAL INNOVATION: FINAL REPORT 147, 155 (1979).

[10] *See, e.g.*, Michael Kremer, *Patent Buyouts: A Mechanism for Encouraging Innovation*, 113 Q.J. ECON. 1137 (1998) (suggesting the government buy out patents after conducting an auction to determine an appropriate buyout price to better address these same fields and others); Steven Shavell & Tanguy van Ypersele, *Rewards Versus Intellectual Property Rights*, 44 J.L. & ECON. 525 (2001) (suggesting government-sponsored cash rewards as partial or full replacements for patents and to better address fields where the disparity between average cost and marginal cost is typically large, citing as examples biotechnology and computer software, which are both focal points in today's debates about patentable subject matter).

[11] For a general critique of rewards-focused approaches to patents, see F. Scott Kieff, *Property Rights and Property Rules for Commercializing Inventions*, 85 MINN. L. REV. 697, 705–17 (2001); and Daniel F. Spulber, *Should Business Method Inventions Be Patentable?*, 3 J. LEGAL ANALYSIS 265, 298–304 (2011).

established market actors will often be better able than smaller market entrants to wield the political influence needed to get the government to act on that information.

One feature that patents have in contrast with other such rewards is that the patent applicants themselves bring to the government much of the information needed to grant and enforce the patent. The patent applicant does this through the process of submitting and prosecuting their patent applications. A second feature of the patent system is that it leaves the competitors of the patentee and of the patentee's business associates in a position where these competitors are putative infringers of the patent. As a result, these competitors have strong incentives to invalidate the patent by bringing to the attention of the government the rest of the relevant information needed to evaluate the validity of the patent, either when the patent is asserted against these competitors in court or during patent office reexamination.[12]

This is not to suggest that focus on incentive to commercialize will overlook inventions themselves. A system successful in commercializing inventions will have the collateral benefit of providing positive incentive to those who do invent because it offers them the possibility of sharing in the many rewards associated with successful commercialization. In addition, significant incentives to invent are otherwise provided by a host of factors that are likely to exist in the absence of a patent system, including invention's famous mother, necessity, as well as innate curiosity and the funding of basic research.

But it does show important reasons for focusing on the goal of commercializing inventions instead of on the goal of making inventions. The patent system can be well designed to accomplish the goal of commercializing inventions in a way that also happens to foster making them without most of the collateral costs of a system focused on making inventions and with a range of mechanisms for minimizing and mitigating the collateral costs of enforcing property rights in patents.

A focus on commercialization brings with it a focus on a particular approach towards dispute resolution procedures. The process of getting an invention commercialized requires coordination among a large number of complementary users of an invention, including venture capitalists, managers, marketers, laborers, and often the owners of other inventions. Such coordination among diverse actors can be greatly facilitated by allowing inventions to be patented and then using dispute resolution procedures to enforce those patents that have relatively low administrative costs and less reliance on flexible discretion over subjective factors. When an inventor has a patent backed up by credible enforcement in court, then that patent can act like a beacon in a dark room to draw to itself all of those interested in that technology and start conversations among them.[13] As long as the patent is predictably enforced, this beacon effect is followed

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[12] Kieff, *supra* note 11, at 712.

[13] F. Scott Kieff, *On Coordinating Transactions in Intellectual Property: A Response to Smith's* Delineating Entitlements in Information, 117 YALE L.J. POCKET PART 101, 102 (2007); *see also*

by a bargain effect because those parties know that only those who strike deals with each other involving the patent can avoid being excluded by the patent in court.[14] Through the enforcement of that patent right and those contract rights, the government is able to help patentees and their contracting parties appropriate the returns to any of their rival inputs to developing and commercializing innovation—labor, lab space, capital, etc.—without the government itself having to trace the relative contributions of each participant and with less risk that political influence will affect outcomes.[15] This decentralized, ad hoc coordination occurs spontaneously, without the government needing to amass any of the specified information it would need to directly target each of the parties.[16] Instead, each party brings its own expertise and other assets to the negotiating table and knows—without necessarily having to reveal it to other parties or the government—enough about its own level of interest and capability to decide whether to strike a deal or not.

Just like the difference between the societal goals of inventing and commercializing reveals a significant difference in nature and degree with respect to the relationship the government needs to have with market actors to implement a patent system, the difference between using court adjudication and administrative agency examination to assess patents reveals a significant difference in the nature and degree of that same relationship. As explored in more detail in prior work, while court litigation is more expensive and time-consuming, it is also less open to political influence and its link between issues of patent validity and infringement provide important, self-disciplining effects on both patentees and alleged infringers.[17] As a result, present trends toward increased reliance on administrative agency proceedings instead of court litigation might make it harder for some new firms to enter and compete in markets. Larger firms generally are thought to be more effective at bringing political influence to bear in agency determinations. In addition, when the relevant agency (such as the Patent Office or Federal Trade Commission) only has power to focus on one of the core substantive areas of a patent dispute, such as validity of the patent or the proper remedy for patent infringement, the proceeding often does not benefit from the important self-disciplining tensions that usually cabin the arguments made by parties on both sides of a district court patent litigation that typically involves all substantive areas of a patent case.[18] For example, an alleged infringer is typically self-disciplined when arguing in defense that the patent is invalid for being so expansive as to

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Henry E. Smith, *Intellectual Property as Property: Delineating Entitlements in Information*, 116 YALE L.J. 1742, 1751–52 (2007).

[14] *See* Kieff, *supra* note 13, at 102.

[15] *See* Smith, *supra* note 13, at 1745.

[16] *Id.* at 1763–65.

[17] *See* F. Scott Kieff, *The Case for Preferring Patent-Validity Litigation over Second-Window Review and Gold-Plated Patents: When One Size Doesn't Fit All, How Could Two Do the Trick?*, 157 U. PA. L. REV. 1937, 1949–50 (2009) [hereinafter Kieff, *The Case for Preferring*]; F. Scott Kieff, *The Case for Registering Patents and the Law and Economics of Present Patent-Obtaining Rules*, 45 B.C. L. REV. 55, 118–22 (2003) [hereinafter Kieff, *The Case for Registering*].

[18] Kieff, *The Case for Preferring*, *supra* note 17, at 1949.

encompass some particular reference (journal article, other publication, or example of public use) of putative prior art by the realization that such a broad interpretation of the patent is more likely to support a decision on the question of patent infringement if it turns out that piece of putative prior art fails to knock out the patent due to a mismatch of dates or an insufficient technological disclosure.[19]

As just one example of this effect, it is notable to observe the past decade of extensive public criticism about patents, much of which has emphasized concerns about the extensive costs, delays, and lack of experienced decision-making made by lay judges and juries in U.S. District Courts when adjudicating patent cases.[20]

Responding to concerns such as these about patent jury trials, the 2011 America Invents Act significantly increased the depth and breath of available internal, rapid, and inexpensive U.S. Patent and Trademark Office (PTO) procedures to more closely scrutinize patent examination in the first instance, and increase options for patent revocation through reexamination or review after patents have issued. With a large budget of 2.5-3 billion dollars (over twice the budget of the main agency charged with regulating the entire U.S. securities markets, the SEC), the PTO has been rapidly increasing its pool of internal administrative patent judges – these are the officers who review the final determination of the patent examiners – from a historical high around 2009 of about 80 to roughly double that number in 2012 and plans to double the number again over the coming year or two.[21]

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[19] *Id*.

[20] The remarks by leading patent commentators, England's Lord Justice Robin Jacob and U.S. law professor Mark Lemley, are representative:

> No one outside America, for instance, regards the use of jury trial as remotely sensible. Robin Jacob, *One Size Fits All? in* F. Scott Kieff, PERSPECTIVES ON PROPERTIES OF THE HUMAN GENOME PROJECT 455 (2003).
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> Could the patent system be improved, for instance in the US by abolishing jury trial…? Robin Jacob, Abolish Patents? Nov 1, 2012, www.ideaslaboratory.com.
>
> Jury trials in patent cases are extraordinarily expensive; reducing their number would presumably result in both quicker and cheaper resolution of patent disputes. Mark Lemley, Why Do Juries Decide if Patents Are Valid?, Stanford Public Law Working Paper No. 2306152, August 5, 2013, at 66.
>
> [Limiting juries to patent damages would] encourage (or perhaps even require) that damages be separated from infringement and validity and tried separately. *Id*. (text in square brackets added to summarize context from source).

[21] *See, e.g.*, Dennis Crouch, Judicial Network of the Patent Trial and Appeals Board (PTAB), December 12, 2013, available at http://www.patentlyo.com/patent/2012/12/ptab-ecosphere.html (citing and linking to Patent Public Advisory Committee Meeting Patent Trial and Appeal Board Update of December 12, 2013). Some have expressed concern that the PTO's newly enhanced procedures for reexamining patents, combined with its

This vast increase in the PTO procedural mechanisms for hauling back patents through application of the legal rules governing patent validity came on top of a decade of enhanced scrutiny about putative antitrust implications of the substantive and procedural rules relating to remedies for patent infringement by both the U.S. Department of Justice Antitrust Division (DoJ, with a budget of approximately 160 million dollars) and the U.S. Federal Trade Commission (FTC, with a budget of approximately 300 million dollars), beginning with joint hearings in 2001 and including the 300 page FTC report more recently issued in 2011.[22] All of these efforts, pursued largely due to expressed concerns about the uncertainty, delay, and costs of patent litigation, were designed to have and did have significant impact in decreasing the ability to enforce patents.

In contrast, the U.S. International Trade Commission (ITC) uses its more modest total budget of 80 million dollars to deploy towards its patent docket, on a time frame widely regarded as significantly faster and less expensive for the parties than district court litigation, the ITC's several significant sets of professional staff with extensive experience in all three main aspects of IP, mainly patent, cases: (1) validity and enforceability, (2) infringement, and (3) remedy.[23] These groups of ITC staff include the following:

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dramatically expanded board of administrative patent judges, will favor large, politically effective businesses in their efforts to delay or prevent small business from having enforceable patents. *See, e.g*., Steve Moore, The AIA: A Boon for David or Goliath?, August 5, 2013, available at http://www.ipwatchdog.com/2013/08/15/the-aia-a-boon-for-david-of-goliath/id=44651/.

[22] *See* Notice of Public Hearings Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy, 66 Fed. Reg. 58,146, 58,147 (Nov. 20, 2001) (announcing joint hearings and explaining the reasons for them); *see also* Press Release, Federal Trade Commission, Muris Announces Plans for Intellectual Property Hearings (Nov. 15, 2001) (collecting sources, including links to Federal Register Notice and to speech by Chairman Timothy Muris, and questioning these and other aspects of the patent system), http://www.ftc.gov/opa/2001/11/iprelease.htm (last visited Nov. 13, 2003); *and* Federal Trade Commission Report, "The Evolving IP Marketplace: Aligning Patent Notice and Remedies With Competition", March, 2011; and http://www.ftc.gov/news-events/events-calendar/2010/05/evolving-ip-marketplace (summarizing decade of hearings and prior reports and their lineage up to the 2011 report). For some recent critiques of these approaches, see Richard A. Epstein, F. Scott Kieff & Daniel F. Spulber, *The FTC, IP, and SSOs: Government Hold-Up Replacing Private Coordination*, 8 J. COMPETITION L. & ECON. 19 (2012); F. Scott Kieff & Anne Layne-Farrar, *Incentive Effects from Different Approaches to Holdup Mitigation Surrounding Patent Remedies and Standard-Setting Organizations*, 9 J. COMPETITION L. & ECON. 19 (2013).

[23] To be sure, the PTO, DoJ, FTC, and ITC each handle significant dockets on matters other than patents, and the budget numbers included in the body text are not offered as precise accountings for detailed comparison. Nevertheless, they are generally informative for the broad discussions about system goals and contrasting organizational and institutional approaches for meeting them. For example, the PTO handles trademarks as well as patents, but the trademark side is a much smaller part of its overall operation. And while

- a large department of expert patent litigators (the Office of Unfair Import Investigations) who operate independently of the Commission under formal conflict of interest rules in furtherance of their legal duty to represent the public's interest in each case in which they elect to participate, which is most;

- a large department of expert IP (mostly patent) lawyers who represent the Commission's interests in following applicable statutes and precedents for adjudicating patent cases (the Office of General Counsel's IP team), most of whom have extensive patent experience and many of whom served as law clerks at the U.S. Court of Appeals for the Federal Circuit, the appellate court in the U.S. that hears nearly all appeals in patent cases, including those from the ITC;

- a group of 5-6 administrative law judges and their staff of permanent law clerks, who collectively spend all of their time adjudicating IP disputes, mostly involving patents; and

- the six Commissioners, each of whom has as least one full-time senior counsel with extensive IP experience devoted to IP matters, mostly involving patents.

Yet, when the ITC was recently faced with its most high-profile patent case in a generation, which involved the so-called smart phone wars between Apple and Samsung,[24] a case that happened to result in the enforcement of a patent rather than elimination of a patent or significant restriction on patent enforcement, the almost unanimous reaction from the major media that had long been calling for faster, more expert adjudication of

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the DoJ and the FTC also handle a much broader set of antitrust matters not involving intellectual property, and the FTC has a large consumer protection docket, both the DoJ and the FTC have been highlighting their IP focused work in their annual budget justifications for years and both have been devoting significant resources towards their significant actions relating to IP over the past decade. Furthermore, of the five main areas of the ITC's operations, IP-based work (so-called Ops 2) is only one of them, with the other areas being: the Commission's largest operational area, Ops 1, import injury investigations, which focuses on antidumping and countervailing duty cases; Ops 3, industry and economic analysis, which prepares reports under Section 332 of the Tariff Act of 1930 and other similar statutes; Ops 4, trade information services, which maintains and publishes an extensive repository of trade and tariff related data regularly used by governments, academics, and business, including the entire Harmonized Tariff Schedule of the U.S. (HTSUS), contributions to the International Trade Data System (ITDS), the set of U.S Commitments under Schedule XX of the GATT/WTO and under GATS, and support for U.S. contributions to the WTO Integrated Database; and Ops 5, trade policy support, through which the ITC helps trade policy makers in the U.S. executive and legislative branches by providing objective consultation involving research and data compilation and analysis, often including formal details of ITC staff to these other parts of the U.S. government.

[24] Neither Kieff nor Paredes was involved in the case.

patent cases was very critical about the outcome, without in most instances even addressing the particular facts or reasoning of the published record or decision.

In that case, after the ordinary full trial proceedings before the administrative law judge, with active involvement of the expert patent litigation attorneys representing the public's interest from the ITC's Office of Import Investigations, the ITC made special, supplemental solicitations for public input on the public interest. These solicitations addressed, among other things, concerns about anticompetitive effects of patent enforcement in the context of technological Standard Setting Organizations and putative commitments to issue licenses on so-called RAND or FRAND terms. The PTO, the DoJ, and the FTC all provided formal submissions, as has occurred in prior ITC proceedings raising similar issues, largely reflecting the FTC's decade of actions expressing significant skepticism about patent enforcement but focused largely on only the broad, general policy concerns of the FTC about antitrust implications of patents, rather than on the particulars of the case at hand.

The result was an extensive record developed through a thorough factual investigation and detailed legal and economic analysis into the core underlying economics of patent hold up, including detailed evidence about whether particular parties were surprised, were opportunistic, made asset-specific investments, what particular patents were related to which particular standards, whether they were essential to those particular standards, what specific terms were involved in any relevant licensing commitments that were made, how each of the particular parties acted in relation to those commitments, etc. Based on this record, the ITC issued a detailed decision spanning roughly 150 pages, including approximately 35 pages devoted to the analysis of this evidence, and an accompanying thoughtful dissenting opinion of approximately 10 pages setting forth detailed reasoning closely tied to the factual record that focuses largely on a different reading of the facts relating to the specific actions of the parties regarding their particular negotiating behaviors.[25]

This is not to say that reasonable minds could not differ on the issues in the particular case. Quite the opposite. The 5-1 vote and carefully written opinions on both sides show that reasonable minds did disagree and were able to explain how they came to their different conclusions based on the particular facts in the record.

Simply put, the ITC processes and resulting opinions involved highly experienced government staff, a time frame and cost dramatically faster and less expensive than district court litigation, relying on government officials having extensive expertise in the relevant technology, economics, industrial dynamics, and law, focused on the facts with extensive and very detailed published opinions that tie the application of the law to the facts of the

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[25] See, 337-TA-794 Commission Opinion (Public Version), July 18, 2013 (including pp. 41-66 focusing on affirmative defenses relating to the SSO, and pp 105-119 focusing on the remedy, the public's interest in the remedy, and how the remedy was tailored to address the public's interest).

case at issue. This all gave significant guidance to future government decision makers and private parties about how the law would be applied to facts of future cases, which would allow for a measure of certainty and predictability that could help parties in organizing their affairs and conducting their governmental and commercial activities based on the facts relevant to particular cases.

Yet, when the executive branch intervened in the case afterwards to set aside the ITC's remedy, the only public information it provided was contained in a single three-page letter, containing only a few lines of text explaining how it was based on the facts of this case. This provided little information to academics, government officials, and businesses, in the U.S. or around the world, about what facts or reasons triggered this different outcome.

The combination of the response by the public media and the response from the executive branch provides little guidance for future decision-makers around the world in both the government and the market sectors about how which particular types of evidence about what specific types of economic issues will have what particular types of legal significance in future cases. Instead, whether correct or not, some might read both as suggesting that significant traction can be accomplished using the less legally formal tools of popular sentiment or political influence. Such a view could find support in longstanding academic literature studying political economy and in the highly developed practices of public and government relations. At the same time, a central lesson from the field of political economy is that the efficacy of these sorts of strategies and tactics tend to favor large, established businesses, which sometimes can come at the expense of competition and innovation.[26]

If this decision reflects that political considerations could end up featuring more prominently in IP enforcement,[27] it will mark a significant departure from the long

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[26] Of course, this is not always the case, as the interests of small business and entrepreneurs can gain significant political momentum from time to time. A recent example from finance is the bipartisan support in Congress that led to the adoption in 2012 of the Jumpstart Our Business Startups (JOBS) Act. That said, the JOBS Act is not really a tale of "Davids" versus "Goliaths" because even some Goliaths stand to benefit from the JOBS Act's effort to facilitate capital formation. More interesting to political economists would probably be the disparate views of the mutual fund industry and the hedge fund industry when it comes to a centerpiece of the JOBS Act – namely, lifting the ban on general solicitations under Rule 506 of Regulation D.

[27] *See*, *e.g.*, Susan Decker and Brian Wingfield, Samsung Loses Bid for Obama Veto of Apple-Won Import Ban, Bloomberg, Oct. 8, 2013 (highlighting significant public speculation about the role of political pressure and domestic bias in the executive branch's decision to intervene against the ITC in the decision to enforce Samsung's patents against Apple, but not soon thereafter in the ITC's decision in the related proceedings to enforce Apple's patents against Samsung); and Deanna Tanner Okun, Commentary: Listen to the Factual

tradition the U.S. has followed in the international setting of being seen as more likely than some other countries to treat its IP enforcement as more a matter of objective application of law to facts and less a matter of domestic political influence, even when involving entire classes of life-saving medicines with significantly sharper impact on large portions of a population than would likely be associated with access to particular models of cell phones.[28] An interesting area for further research will be to see whether and in what ways the decision to set aside the fully adjudicated result in the smart phone case inside the U.S. will be relevant to future trade proceedings on the international scene.

The discussion thus far has offered a thumbnail sketch of two basic choices a society can make about the patent system as an institution: overall goals and types of dispute resolution or enforcement. The particular choices a society makes on both of these central issues can tilt the system to favor those who will be better able to wield political influence. This often could benefit large, established market actors over smaller market entrants. As discussed more fully in the Parts IV and V, a similar dynamic can be seen in the areas of antitrust and securities regulation.

III. THE BASICS MATTER FOR ANTITRUST & COMPETITION

The interface between patents and antitrust happens to have been one of the two central motivators behind the patent system that existed in the U.S. between 1952 and 2011, and to some extent may continue to this day. This system was codified as the 1952 Patent Act. In fact, one of the two principle drafters of the '52 Act, Giles Rich, wrote a series of five articles in the 1940's on the topic. And while the 1940's were indeed a long time ago, the approach elucidated by Giles Rich, who went on to be the longest sitting federal judge in the U.S., the world's most famous patent scholar and jurist, the widely recognized father of the modern U.S. patent system, and a judge on the court that hears most patent appeals, in these papers were considered to have sufficient ongoing salience that they were selected for republication in a 2004-2005 volume of the Federal Circuit Bar Journal.[29]

The '52 Act's approach is focused on predictable, fact-based validity and enforcement rules for patents as well as for regulation of the IP-antitrust interface as compared to the more flexible approaches advocated by various government agencies, including the DoJ and FTC, as well as many current commentators. And in addition to Rich, other leading commercial jurists from diverse political perspectives at the time like

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Record on the ITC, Not the Broken One, Roll Call, Nov. 25, 2013 (discussing politics behind efforts to amend statute to eliminate ITC role in broad categories of patent cases).

[28] *See, e.g.*, Richard A. Epstein & F. Scott Kieff, *Questioning the Frequency and Wisdom of Compulsory Licensing for Pharmaceutical Patents*, 78 U. Chi. L. Rev. 71 (2011).

[29] *See* Rich, *supra*, note 7.

Learned Hand and Jerome Frank, also took special care to highlight the strengths of that approach.[30]

The judiciary was not the only branch of government to champion the strengths of the ’52 Act’s approach. Rich provided extensive and explicit testimony before Congress about the goals of the ’52 Act in re-aligning the interface between patents and antitrust in both the patent licensing and patent enforcement settings and in creating an objective standard for determining patent validity. And Congress, of course, agreed with the approach he offered in his testimony when it voted for the statute. Later, the Supreme Court expressly and extensively relied on that legislative history, and especially Rich’s testimony, in the well-known *Dawson* decision on patents and antitrust in 1980.[31] The Supreme Court also endorsed the ’52 Act’s approach in the 2006 *ITW v. III* case, another case focusing on the patent-antitrust interface.[32]

Both major political parties in the U.S. have similarly embraced this approach when in control of the executive branch. Judge Pauline Newman, for example, has reminded on several occasions that during the late 1970’s, when the economy was in difficult times, like it was in the 1940’s (and, we would add, after the 2008 crash), a very diverse pair of U.S. Presidents decided to adopt an approach to patents like that in the ’52 Act, as urged by Rich, Federico, Hand, Frank, and others.[33] President Carter, a Democrat, decided, after a careful study, to put forth a statute designed to strengthen the patent system by creating the Federal Circuit. President Reagan, a Republican, signed the bill to much fanfare after Congress passed it.[34]

The intellectual history of this school of thought, including its practical impact on legal systems in the U.S., is briefly recounted above in part to serve as a reminder of how many key issues of today were addressed in the past.[35] The extensive debate about the patent and antitrust interface that has unfolded in the U.S. and around the world over the past decade might benefit from consideration of this intellectual history, especially given the diverse support it received for many years. History can sometimes offer us some good ideas, as well as good reasons for not pursuing others.

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[30] See discussion of leading jurists of commercial from diverse political perspectives, *supra*, note 7.

[31] Dawson Chem. Co. v. Rohm & Haas Co., 448 U.S. 176 (1980).

[32] Ill. Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006).

[33] Pauline Newman, “The Federal Circuit in Perspective,” 54 American University Law Review, 821, 822–23 (2005).

[34] The relevant conclusions of the study can be found at Industry Subcommittee for Patent & Information Policy, Advisory Committee on Industrial Innovation, Report on Patent Policy, 155 (1979). The statute that resulted is the Federal Courts Improvement Act of 1982, P.L. 97–164, 96 Stat. 25 (April 2, 1982).

[35] The impetus for such a reminder is the degree to which the ’52 Act’s approach, including the writings about it by such a diverse group of leading commercial jurists as Learned Hand and Jerome Frank, is overlooked today in many discussions on the topic of IP and antitrust.

It also is provided because the characteristic predictability of the '52 Act's approach may again be in question in ways that may have implications far beyond traditional notions of the patent-antitrust interface. Consider, for example, the recent debates about the FTC's power under Section 5 of its 1914 statute,[36] and the recent Supreme Court decision in *FTC v. Actavis*, on March 25, 2013, a case initially brought by the FTC asserting its Section 5 power.[37]

A central reason why the FTC's Section 5 power attracts controversy is that this somewhat lesser known statute stands against the backdrop of the more well known antitrust statutes of similar vintage, such as Sections 1 and 2 of the Sherman Act of 1890, which target particular, well recognized categories of evidence of market power, the Clayton Act of 1914, which targets particular, well recognized categories of collusive anticompetitive behavior, and even the more recent 1976 Hart-Scott-Rodino Act, which refines the particularized behavior-based approach of the Clayton Act to require procedures for review of certain categories of transactions like mergers and acquisitions. Section 5, on the other hand, is much more open-ended. It has been long recognized that FTC's Section 5 must cover something more than these other antitrust statutes. The debate has been over what exactly this "something more" is – in other words, over the scope of Section 5. And today's uncertainty about this Section 5 power stems from current actions that test its limits.

Recently, FTC Commissioners Maureen Olhausen and Joshua Wright have proposed a set of guidelines designed to articulate a clear framework for determining when Section 5 has been violated and when it has not.[38] Their focus is on how to enable relatively easy determinations about what lies within the zone of legality, and what falls within the zone of illegality. They do so by focusing on identifying both particular harms to competition as well as particular countervailing efficiencies of suspect conduct. That gives effect to the notion that Section 5 power does reach beyond the other antitrust statutes while also mitigating risk of significant collateral costs to its use.

Although the FTC Section 5 power extends far beyond IP, the Olhausen & Wright approach to it is very much in keeping with the historically influential approach to the patent-antitrust interface of the '52 Act, discussed above. In this paper we just briefly re-emphasize a point we have made in prior work about an additional feature of approaches similar to those adopted in the '52 Act and explored by Olhausen & Wright, which is something we have labeled as the "basics matter."[39]

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[36] 15 U.S.C. § 45, which gives the FTC broad power to regulate "Unfair methods of competition."
[37] FTC v. Actavis, Inc., 570 U.S. ___ (2013).
[38] See, http://ftc.gov/speeches/wright/130619umcpolicystatement.pdf, http://ftc.gov/speeches/ohlhausen/131018section5.pdf
[39] F. Scott Kieff & Troy A. Paredes, *The Basics Matter: At the Periphery of Intellectual Property*, 73 Geo. Wash. L. Rev. 174 (2004).

The "basics matter" approach requires a mindfulness of the important goals and concerns of the diverse perspectives that have informed the development of different areas of law for which there is broad consensus. To be clear, the "basics matter" approach does not make the strong claim that current legal regimes are perfect or cannot be improved upon. We appreciate that policy makers must strike different balances over time and that the inevitable flaws of a system cannot be ignored. Furthermore, even if, on net, such an approach looks pretty good, one size may not fit all. Other approaches may be well suited in different areas at different times.

Consider an example of two or more sophisticated business parties in an ongoing voluntary commercial relationship. The "basics matter" approach encourages careful attention to the full contours of what a law student might call the "black letter law" relating to property and contract, including the rules about what makes a property right or contract valid and enforceable and on what terms, as well as the same basic features of the "black letter law" of antitrust, including, for example, attention to factual evidence about actual market power or its threat.

In the context of the FTC's Section 5 power when used to asses a case involving potential fraud or failure to live up to one's particular commitments (FRAND or otherwise), the "basics matter" approach would require accurate and full consideration of the particular frameworks for existing positive law regimes, such as "fraud" and "contract," or existing bodies of well accepted economic concepts such as "hold up," as well as the history of the normative debates leading to their evolution. This takes into account the diverse perspectives of those deep in the trenches of each of these particular fields of law – including judges, policy makers, academics, lawyers, and others – before finding that there are penumbras that might obscure each field's clear boundaries. Doing so can help mitigate the risk that attention to one concern does not inadvertently eclipse or elide countervailing concerns. Broadly informed, deliberate choices often can play out better than a single-minded effort to address one perceived need.

Doing so also calls on decision makers to expressly identify the perceived failures of the established regimes before creating new doctrines and approaches to resolve the putative failures. The mere formality of identifying and rigorously considering the different bodies of law and the diverse goals that motivated their creation can result in greater respect for the dignity of those bodies of law and economics and the widely recognized expertise embedded within diverse perspectives that informed them. It also helps ensure that, if the law is to change, there is more transparency into the reasons why, more accountability on the part of those making the change, and more guidance for governmental and private actors to follow going forward.

Consider as a legal example a setting (such as the common law) in which the legal test for fraud requires factual evidence of four factors: (1) misrepresentation of a material fact; (2) intent; (3) justifiable or reasonable reliance; and (4) injury. The "basics matter" approach to FTC's Section 5 would begin by asking which particular element of the legal

test for common law fraud is being overlooked in order to bring the case under the FTC's Section 5. The "basics matter" approach would also ask for an explanation about why the reasons offered by those who had advocated for the inclusion of this element in the legal test for fraud should be overcome in the setting of a Section 5 case. Put differently, it would endeavor to elucidate the full set of costs and benefits of essentially changing the balance struck by an existing legal rule so that attention can be paid to the well-founded reasons for having not done so in the past. The common sense question would be: If there is no common law fraud violation, why should there be a Section 5 violation for fraud? Conversely, if there is a common law fraud violation, what's the impact of also (or instead) bringing a Section 5 claim? Putting a finer point on it, if the common law of fraud includes as one of its factors the requirement of intent (or one of the other four factors listed above), what are the reasons why a legal system such as that would have decided to allow liability to turn on evidence of that factor; and what are the risks of allowing liability to arise in an alternative legal regime without requiring there to be any evidence of that factor?

Consider as an economics example a setting in which "hold up" is seen as a particular problem arising out of the interaction between asset-specificity and opportunism, as Oliver Williamson has discussed in his Nobel Prize winning work on transaction cost economics.[40] Given this view of "hold up," in the context of remedies for patent infringement, the "basics matter" approach would be open to decreasing or eliminating patent remedies in particular cases based on specific factual evidence of these two factors (asset specificity and opportunism), including evaluating the interaction between them, rather than allow open textured policy debates about the possibility of holdup in general to drive outcomes in particular cases without any factual underpinnings adjudicated in those cases.[41]

In the context of the Supreme Court's recent *FTC v. Actavis* decision in March, 2013, the "basics matter" approach would look to carefully understand the particular inefficiency alleged in similar cases. This is largely consistent with the general outcome in the case but would provide some more detailed guidance than the Court had occasion to provide in its opinion.

The *Actavis* case involves the settlement of a patent case that occurred within the very complicated statutory framework called the Hatch-Waxman Act that governs disputes between branded and generic pharmaceutical businesses and that sits at the interface between the fields of patent law and food and drug law. In that case, involving a type of transaction that is not rare, the dispute settlement involved what some antitrust regulators call a "reverse-payment" from the plaintiff-patentee to the generic infringer in exchange for the generic's commitment to stay out of the market for a particular period of time. Antitrust concerns arise in that setting because it looks on first glance like the patentee and infringer may be colluding against the rest of the market in keeping the court from reaching

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[40] *See, e.g.*, Oliver Williamson, The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting 61-63 (1985).
[41] *See, e.g.*, Kieff & Layne-Farrar, *supra* note 22.

a result that occurs in roughly half the patent litigations:[42] the patent is adjudicated to be ineffective in keeping competitors off the market, either because it is invalid or because it has much narrower effective scope than might appear at first glance. The FTC took the position that such settlements are illegal *per se* based largely on this first-glance appearance of an anticompetitive collusion. The parties to the underlying patent suit argued that the settlement should generally be left alone. Worried that the amount of the payment may simply have been "too much" to represent the risk-adjusted value of the underlying patent dispute, the Supreme Court reached what might be seen as a middle ground and decided that these settlements have to be evaluated under the well known (in antitrust circles) standard of "rule of reason," which generally requires specific evidence particularly tied to problems most economists generally agree are associated with competitive inefficiencies.

It is tautological that "too much" of something (or "too little" for that matter) is problematic – the modifier "too" conveys the fact of excess. The key question is what constitutes "too much." The "basics matter" approach, therefore, would begin by recognizing that the Supreme Court's concern about the payment being "too much" is itself too vague. To illustrate the ambiguity of "too much," the following discussion briefly offers two reasons why a particular financial payment paid by one side to settle a dispute may look to an outside observer to be out of proportion or "too much."

First, while the particular court adjudicating a dispute typically is restrained by formal legal rules to have only limited power, which is more technically known as jurisdiction over subject matter and people (or businesses), the parties to a particular dispute can exert control over all that they actually control and may take a broader range of business interests into account. Often this includes both subject matter and affiliated entities far beyond the reach of any particular court action. As good mediators often remind parties during settlement negotiations, this can offer opportunities for gains from trade not unlike other business transactions where companies try to maximize value across the entire enterprise. The parties to the dispute may be better off entering into a voluntary deal anytime one of those aliquots of value would be worth more if it were subject to the other party's control as a result of exchange or contract. As a result, there is no particular reason to have any preconceived idea when studying the settlement of a dispute between sophisticated parties of either the magnitude or the sign of the nominal settlement amount.

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[42] Of course, patent litigation is to a large extent like many forms of litigation in which one would generally expect the plaintiffs (or defendants) to win only half the cases, essentially because the more certain the parties are about the resolution of the dispute, the more likely they will agree to settle and avoid the uncertainty, delay, expense, and public outcome of litigation. *See, e.g.*, George L. Priest & Benjamin Klein, The Selection of Disputes for Litigation, 13 J. Legal. Stud. 1 (1984). *Compare*, Jason Rantanen, Why Priest-Klein Cannot Apply to Individual Issues in Patent Cases, working draft (March 31, 2013).

To be sure, the value may be the direct result of purely anticompetitive collusion – for example, the knowing settlement of a baseless patent infringement case – and good evidence of such behavior should be admissible to inform the rule of reason analysis. Evidence of other particular harms also should be considered when available. But so should evidence that other aliquots of value actually drove the nominal settlement amount, which should then militate against antitrust liability. At the same time, a searching analysis during antirust review of all the detailed merits of the underlying patent dispute in every case in which there is settlement risks eroding the social benefits normally associated with allowing settlements of commercial litigation.

Second, as those familiar with basic U.S. trademark law well know, trafficking in a "naked" mark is not allowed and renders the mark legally invalid. More specifically, as in many trademark systems in the world, because a U.S. trademark must be something that signifies a particular quality of the underlying good or service, any sale or license of the mark must be accompanied by the associated indicia of quality. In the context of a trademark for a bakery, for example, any sale or license of the mark must be accompanied by requirements that particular recipes be followed, often including that particular types of ingredients and equipment be used. As a result, the crux of many trademark deals can look from afar like a payment by the one buying or taking a license to the one selling or granting the license plus a requirement that the one paying subject itself to the control of the other. A casual observer might wonder why one party would pay a large sum only to also subject itself to the control of the other. But while the observer might think the payment is "too much" and thus signals something illicit about the transaction, a person experienced in trademarks realizes that this is the best way for both parties to maintain the value of the mark, the basis of the transaction in the first place.

The "basics matter" approach would be vigilant about keeping in mind concerns of these types as well as others, while also searching for evidence of actual anticompetitive effect. The approach recognizes that absent mindfulness about categories of value that might be below the waterline, the incomplete picture that is the tip of the iceberg can allow more open-textured, discretion-based enforcement systems to become too persuaded by political considerations. As a result, misimpressions and misunderstandings can arise that can lead to what in fact may be sensible, efficient arrangements among parties being treated as impermissible restraints of trade.

Although the above discussion of antitrust only addresses a few narrow points within the broad field, it is designed to highlight a single common theme that is common across each of these points and can inform policy-making going forward. Antitrust enforcement in general is a good thing, including at the IP-antitrust interface; and more of it may be good as well. But an important theme in the creation and implementation of the IP-antitrust system that existed in the U.S. under the 1952 Patent Act is that the applicable rules should be predictable and fact-based, rather than vague and ambiguous and thus subject to the undue discretion of government actors. There are benefits from maintaining broader antitrust enforcement powers like those in FTC's Section 5 by implementing such a predictable and fact-based approach because, among other things, its can reduce the risk

that undue political influence will impact outcomes. In this way, the system of competition laws can help foster innovation and market entry, a rich source of which are smaller competitors that are often significantly less politically active.

IV. SECURITIES REGULATION AND FINANCING INNOVATION

Having discussed aspects of the patent and antitrust systems, we now turn to select institutional features of securities regulation. As with the other fields already discussed, the field of securities regulation is very large, and rapidly growing, involving far more than can be well covered in a single part of a single paper.[43] The discussion below focuses on just two aspects of the securities regulation system: how the structure and perceived goals of the SEC can influence how the agency administers the federal securities laws and the ultimate real-world impacts for the U.S. capital markets. It begins with a brief sketch comparing the structure of the SEC with that of the ITC to suggest how institutional features such as the number of commissioners and whether the Chair rotates can impact agency decision making by impacting who wields what influence. The discussion then continues by illustrating how an agency may put its independence into practice by taking advantage of the discretion it has when fashioning the regulatory regime. The discussion then elucidates how a narrow understanding of "investor protection" that drives policy making can in important respects disadvantage certain investors by impeding capital formation, such that stated policy goals may actually be undermined. More generally, how an agency views its goals informs how it administers the regulatory regime it is responsible for.[44] To provide an example of these points, we review a recent development that is particularly consequential for the financing of innovation: the Jumpstart Our Business Startups Act of 2012, commonly known as the JOBS Act.[45]

The SEC is regarded as "independent" because it has no formal reporting relationship to the executive branch and Commissioners cannot be removed other than for cause. Accordingly, independent administrative agencies like the SEC, ITC, and other

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[43] For a detailed analysis of the breadth of the federal securities laws, see Louis Loss, Joel Seligman, & Troy Paredes, Securities Regulation (11 volume treatise on the topic).

[44] This echoes the point made above regarding how the goals of the patent system (encouraging inventors to invent or facilitating commercialization) can impact how that system takes shape.

[45] Although a single piece of legislation, the JOBS Act was designed to have several distinct areas of impact, including (1) reducing the disclosure obligations and other regulatory burdens that so-called "emerging growth companies" confront when going public, thereby providing what is being called an "IPO on-ramp" for growing businesses; (2) lifting the restriction on general solicitations in private placements under Rule 506 of Regulation D; (3) facilitating "crowdfunding"; (4) making Regulation A more useful for offering securities; and (5) increasing the shareholder threshold at which a private company is forced to report publicly.

commissions are said to be less subject to political pressures.[46]

The politically-divided nature of commissions like the SEC, in which no more than three of its members can be from the same political party, not only helps ensure that a broad range of perspectives are brought to bear when the regulatory regime is shaped, but it also can help to shore up the agency's independence. It also means that a majority of the Commission and the Chair (of the Commission) are from the party of the then-sitting President (of the country) or at least is comprised of individuals who generally would be viewed as sharing the administration's basic views on relevant issues. In addition, while a Presidential term is four years long, and Presidents can serve no more than two terms, the terms of SEC Commissioners last five years, which means a two-term President usually has the occasion to make at least one appointment to each of the five Commissioner posts, and more than one appointment to some of the posts. The net impact is that there can be a close link among the views of the President, the Chair, and a majority of the Commission. In addition, for several reasons, the Chair can direct the agency staff in a way that other Commissioners cannot.[47] This allows the Chair to have much more influence than the Chair's control over the agenda would itself afford or than the Chair's single vote on matters before the Commission would imply. Furthermore, because of the Sunshine Act, no more than two Commissioners can directly interact outside an open meeting on important rulemakings. The Sunshine Act, therefore, can make it difficult for Commissioners to coordinate, which can have the effect of further empowering the Chair. In sum, much of what the SEC does in administering the federal securities laws is not the product of the collective judgment of the five Commissioners but more closely reflects the views and direction of the Chair.

In contrast, the ITC[48] is a six-member commission, typically evenly split between the two major political parties (there sometimes is an independent, just as there can be at the SEC), and serve in terms lasting nine years, with the position of Chair required by statute to switch political parties every two years. As a result, the Commission Staff generally work closely with all of the Commissioners, recognizing that every two years the Chair will have to rotate and that many of the Commissioners have a good chance of serving some time as Chair. The net impact is that the ITC has long operated by consensus, with close coordination among the six members and the Commission Staff, independent of both the executive and legislative branches. When there are splits in the votes of the ITC Commissioners, they often happen not to fall along party lines.

By comparison, the SEC is able to, and occasionally does, act when only Commissioners of a single political party are in support. Of course, an SEC Chair could

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[46] *See generally* Stephen Breyer, Breaking the Vicious Circle: Toward Effective Risk Regulation (1993); James M. Landis, The Administrative Process (1938).
[47] In part, this is related to the basic internal structure and organization of the Commission, including the Chair's primary role in hiring senior leadership, and setting the agenda.
[48] We use the ITC here for purposes of comparison. Contrasts also can be drawn with other governmental bodies, such as the Federal Reserve Board and the FDIC.

choose to adopt a norm of only advancing rulemakings on a 4-1 basis to ensure broader support for an initiative, but the Chair is by no means obligated to do so and there can be good reasons not to do so, such as a potentially undue biasing in favor of the status quo if a 4-1 (let alone a 5-0) vote is required to move a rule forward.

To the extent policy makers want to have agencies outside of the executive branch that are independent, these differences between the SEC and the ITC provide two different models for how it can be implemented, including the likely consequences of different institutional arrangements.[49] The dynamics are notably different at an agency with six members as compared to five and where the Chair rotates as compared to being fixed as to the party that holds it throughout a President's term.

The JOBS Act illustrates an interesting dynamic that can play out in the relationship between the administrative state and Congress. More specifically, it shows how a commission might choose to exercise the discretion that its independence can afford it.

When addressing a joint session of Congress in 2011, the President expressed his intent to "cut away the red tape that prevents too many rapidly growing startup companies from raising capital and going public."[50] On April 5 of 2012, the President signed into law the JOBS Act to do exactly that after Congress had passed the bill on a bipartisan basis in both houses of Congress. The goal motivating the legislation was to spur the economy and job creation by making it easier for companies to raise the capital they need to invest and hire. As the economy continued to sputter, there was widespread support for legislative action to encourage growth and employment, particularly if the legislation was seen as fostering a more conducive (i.e., less burdensome) regulatory environment for startups and other smaller businesses. The JOBS Act also reflects a "Main Street" sentiment through its creation of a new regime permitting "crowdfunding" that could help neighborhood businesses get off the ground while offering "mom and pop" and other retail investors new opportunities to invest.[51]

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[49] Notwithstanding their differences, the SEC and the ITC are both more similar to each other in terms of their structure than either is to the Consumer Financial Protection Bureau, which is headed by a single administrator instead of a politically-divided commission. Nevertheless, the difference is somewhat tempered for the SEC in practice given the influence that the Chair can exercise through the staff and outside the context of a rulemaking that requires the support of at least two other Commissioners.
[50] Address by the President to a Joint Session of Congress, *available at* http://www.whitehouse.gov/photos-and-video/video/2011/09/08/president-obama-presents-american-jobs-act-enhanced-version#transcript.
[51] As the President remarked at the White House signing ceremony,

> And for start-ups and small businesses, this bill is a potential game changer. Right now, you can only turn to a limited group of investors – including banks and wealthy individuals – to get funding. Laws that are nearly eight decades old make it impossible for others to invest. But a lot has

In light of its broad political base of support leading up to its enactment, one might expect that it would have been smooth sailing for the JOBS Act thereafter. But that has not been the case. The implementation of the JOBS Act by the SEC has proven to be controversial, especially the SEC rulemaking to implement Title II of the Act.

Section 201(a) of the JOBS Act directs the SEC to lift the ban on general solicitation in certain securities offerings that are conducted under Rule 506 of Regulation D.[52] Regulation D, which the SEC put into place in the early 1980's to bring certainty to what constitutes a private placement under Section 4(2) of the Securities Act of 1933 in order to facilitate capital formation, provides issuers an exemption from the burdensome registration requirements of Section 5 of the '33 Act that apply to public offerings.[53] At a July 10, 2013 open meeting, the SEC fulfilled its rulemaking obligation under the JOBS Act and amended Regulation D by adding new Rule 506(c) that does lift the ban on general solicitation.

But on the same day, the SEC also took another crucial step that had a countervailing effect. ,By a 3-2 vote (with one of the authors of this paper, who publicly expressed his support for the JOBS Act, dissenting[54]), the SEC also proposed a host of new and cumbersome regulatory requirements that an issuer would have to satisfy to avail itself of the flexibility that the JOBS Act otherwise permitted when raising capital. The concern animating the proposal is that if issuers are allowed to advertise, fraudsters will be able to perpetrate more fraud and so, therefore, restrictions need to be placed on the capital raising process in order to protect investors. However, proponents of lifting the ban have

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> changed in 80 years, and it's time our laws did as well. Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors – namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in.

Remarks by the President at JOBS Act Bill Signing, *available at* http://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing.

[52] Had the SEC chosen too, it could have eliminated the ban on general solicitation on its own initiative at any time by amending Regulation D, an SEC rule. The SEC, however, did not ease the ban and the mounting political pressure designed to force the agency's hand resulted in Section 201(a).

[53] Issuers that generally solicit can only sell securities to "accredited investors" and must take "reasonable steps" to verify that all purchasers are in fact accredited.

[54] *See* Commissioner Troy A. Paredes, U.S Securities & Exchange Commission, Statement at Open Meeting Regarding the Final Rule Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings (July 10, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539701591#.Utw_Dv30B-U.

pointed out that other important investor protections are in place, including the longstanding antifraud provisions of the federal securities laws and the JOBS Act requirement that an issuer that generally solicits must take "reasonable steps" to verify that all purchasers of the securities are "accredited investors." They also have commented that the cumulative compliance burden is too costly, that certain filing requirements could delay offerings, and that many of the proposed requirements are unworkable. In addition, the strongest objections to the SEC's proposal have been directed toward the proposed one-year disqualification from engaging in a private placement under Rule 506 for an issuer that fails to make its so-called Form D filing with the SEC. The concern underlying these objections is that the sum of all of this will work to discourage issuers from generally soliciting. In fact, the ban on general solicitation has already been lifted, the uncertainty that the proposal itself has caused may be deterring issuers from doing so.

As explained above, the SEC lifted the ban on general solicitation but did not stop there having met the legislative mandate. To the contrary, what the SEC was obligated by Congress to give with one hand, the SEC has proposed to take away with the other[55] by advancing a number of regulatory requirements that, in the view of many, could have the effect of undercutting what the JOBS Act sought to accomplish.

This sort of back-and-forth between an independent administrative agency and Congress brings attention to an important dynamic in how the administrative state and the legislative branch interact. The academic literature on administrative agency independence often stresses the factors that go into determining the degree to which an agency is independent, such as for-cause removal of commissioners, an agency's funding, and the impact of congressional hearings on agency activities – which are all important inquiries.[56] What the JOBS Act experience at the SEC demonstrates is just how assertive an administrative agency might be in exercising the discretion its independence affords it. An independent administrative agency may view itself as having a great deal of discretion, even in the face of a congressional directive. That institutional dynamic is important enough on its own in that, for example, many believe that the outstanding general solicitation proposal, if it is adopted, would go a long way toward negating Title II of the JOBS Act as a practical matter. But the dynamic that the rulemaking illustrates could have more far-reaching consequences. In the future, instead of simply directing an

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[55] The SEC has yet to act on the proposal.

[56] Another institutional dynamic that bears on the question of the independence of financial regulators that we plan to address in future work is how the Financial Stability Oversight Council (FSOC), which the Dodd-Frank Act created, can be used by a Presidential administration to bring pressure to bear on independent administrative agencies, including the SEC and the Commodity Futures Trading Commission. The FSOC could be seen as condoning the kind of executive branch interference that the independence of administrative agencies is expected to guard them from. *See, e.g.*, Daniel M. Gallagher, Commissioner, U.S. Securities & Exchange Commission, Remarks at "The SEC Speaks in 2013" (Feb. 22, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1365171492342#.Ut7wkf30B-U.

administrative agency to do something, Congress might more frequently see fit also to prohibit the agency from taking any steps to frustrate the congressional directive. Stated differently, Congress might do more to constrain the administrative state's discretion. In the alternative, Congress might delegate less to administrative agencies in the first instance and do more legislatively instead of through the rulemaking process over which Congress exerts less control. This tension between the legislature and an independent commission suggests further research might be needed to consider the costs and benefits of Congress taking a more direct role in shaping regulatory regimes and delegating less to administrative agencies.

A key institutional feature that impacts how an administrative agency (such as a commission or other regulator) administers its regulatory regime is its sense of purpose or mission. This is not mere rhetoric. Just as a commission's structure and composition can determine outcomes, a commission's stated goals – what its core job is – can significantly impact the shape and substance of the regulatory regime that the commission puts in place and how it is enforced.[57] It can significantly influence the tradeoffs policy makers are prepared to make across a range of outcomes by informing how costs and benefits are balanced. Indeed, depending on how any commission (or other agency) views its goals, certain benefits and costs may be overlooked.

In the case of the SEC, its Website states: "The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." This slogan stands on top of another one that continues to have powerful resonance and that is from one of the early and most prominent Chairs of the SEC: William O. Douglas. In September of 1937, Douglas became the third Chairman in the agency's then-short history — a position he held before going on to become a Supreme Court Justice. In his first press conference upon being named Chairman, Douglas pronounced his view of the SEC's purpose, declaring: "We are the investor's advocate."

Although it has long been recited regularly, the plain text of Douglas' slogan is not very telling unless one has a particular view of what investors want the SEC to be advocating for. The example provided by the JOBS Act shows how a narrow understanding of what it means to "protect investors" can sometimes come at the expense of what is best for investors.

"Investor advocacy" is usually framed in terms of protecting investors from fraud and manipulation or other abusive behavior. Without question, investors stand to benefit from a regulatory regime that empowers them with information and takes other steps to mitigate the risk that investors will be abused. Indeed, for our capital markets to function properly, investors need to be confident that they are adequately informed about their investments, and they need to be secure that their investments will be protected from others' wrongdoing. An effective SEC is key to ensuring the proper robustness and

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[57] We saw this point illustrated earlier in the context of the patent system and whether the goal is to encourage invention or facilitate commercialization.

enforcement of the regulatory regime. A conception of investor protection that stops there, however, is incomplete. Even as investors frequently — although not always — welcome more disclosure, and even as investors may encourage the SEC to regulate abuses and root out malfeasance, investor protection – that is to say, being the "investor's advocate" – is about advancing a considerably broader set of investor interests.

Consider capital formation. As the "basic matter" approach would remind us, promoting capital formation is one of the SEC's fundamental purposes and it is the explicit goal of the JOBS Act. An overarching objective of the federal securities laws is to encourage investment so that businesses can raise the capital they need to spur economic growth. That said, in policy discussions about particular regulatory initiatives, such as lifting the ban on general solicitation, the goal of capital formation is often pitted against the goal of investor protection — as if to take a regulatory step to ensure that the regulatory regime is sufficiently flexible and tailored to promote capital formation comes at the expense of investor protection. When it is framed this way, capital formation tends to get discounted as a goal when the question is whether regulatory demands should be eased to allow companies to raise capital more easily. This perspective might be different if facilitating capital formation were itself seen as advancing core investor interests and not just beneficial to issuers.

Investors primarily invest so that they can earn income and accumulate wealth. This means that investors need opportunities to invest. More to the point, it means that investors are better served when they are offered more legitimate investment choices. If the regulatory regime stifles capital formation by making it more difficult and more costly for businesses to raise funds, investors enjoy fewer investment options and firms investors do invest in may be disadvantaged by a higher cost of capital or, in more extreme circumstances, an inability to raise needed funds. In other words, capital formation can be seen as part and parcel of a more expansive conception of investor protection and what it means to be the "investor's advocate" that credits the full range of investor interests, including investors' desire to commit their financial resources to productive opportunities.

All of which is to say that important benefits can inure to investors when steps like the JOBS Act are taken to facilitate capital formation and investors end up with more choices for putting their money to work. This basic point – that capital formation can benefit investors too – could bear on how the JOBS Act ultimately is implemented and on how other efforts to ease regulatory burdens in order to facilitate capital formation fare in Congress and at the SEC. Many are already advocating for a JOBS Act 2.0, and earlier this month the House passed a bill 422-0 to ease regulatory burdens for small business merger and acquisition (M&A) brokers. But certain groups have voiced concerns, if not outright opposition, to the M&A brokers bill, suggesting that they would try to block the legislation in the Senate where a similar bill has been introduced.[58]

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[58] *See* Mark Schoeff, Jr., Critics Say House Bill Would Create "Wild West" for Private Placements, InvestmentNews, Jan. 17, 2014, *available at* http://www.investmentnews.com/article/20140117/FREE/140119908#.

A more broad-based perspective as to what is in the best interests of investors might yield better results for investors than a singular focus on protecting investors from fraud and manipulation, notwithstanding the importance of guarding investors against wrongdoing. Stated differently, a more inclusive conception of what it means to be the investor's advocate mitigates the risk that well-intentioned policy may prove to be counterproductive in meaningful respects. At a minimum, capital formation, as a basic goal of the federal securities laws, should be given greater attention than sometimes has proven to be the case, at least in recent years. This reiterates a core point of the "basics matter" approach explored in Part III, above – namely, that it is important that attention to one concern does not inadvertently eclipse or elide countervailing concerns.

We recognize that in actuality it is more complicated and nuanced than this discussion would suggest. Not only are the federal securities law highly technical, but it is not likely the case that all investors are better off or that all are worse off as a result of a particular agency decision, be it a rulemaking or otherwise. Instead, some investors are likely to be better off and some worse off. There are very different types of investors that fare differently under different regulatory regimes. But even this recognition helps advance the thinking because it forces a different discussion and analysis than one that too often is framed in terms of investor protection vs. capital formation or investors vs. issuers. Rather, one needs to evaluate the degree to which certain investors might in effect be required to bear certain costs (such as foregone investment opportunities if companies are unable to generally solicit) in order for the SEC to benefit other investors by protecting them from certain abuses. This is not to say what one should decide when asked to make this type of tradeoff. Instead, it is to introduce the very difficult question of how to evaluate and balance a regulatory initiative that disadvantages some investors while benefitting others: an investor vs. investor framing of the policy choices that the SEC often confronts. In these instances, it is not easy to see what the right choice is for the investor's advocate, realizing that whatever the agency decides to do, some investors will be better off and other investors will be worse off. At the very least, discussion and analysis in these terms helps to further elucidate the SEC's reasoning in a way that could provide guidance to others and that could help ensure that the full range of investor impacts is accounted for.

V. CONCLUSION

Using some basic insights from political science and economics to highlight particular examples of key incentives and constraints that are acting upon the individuals and organizations in both the market and government sectors within some significant components of current legal systems designed to foster innovation, competition, and finance, such as IP, antitrust, and securities regulation, this paper has explored some important features of various specific areas within the institutions of patent law, competition law, and financial regulation. Taking seriously the goals usually articulated with significant consensus in public policy debates about those public institutions, particularly during debates about their reform, it elucidates contrasting approaches to the

design of representative institutions in these fields to highlight some basic themes in the way the legal rules are implemented with an eye towards the impacts they tend to have in the real world. It points out some particular reasons why for certain common themes in the design of these institutions, stated policy goals may not be well served and risk of significant collateral costs may be especially high, as well as some contrasting approaches that are likely to well satisfy stated policy goals while minimizing risk of collateral cost.