2012

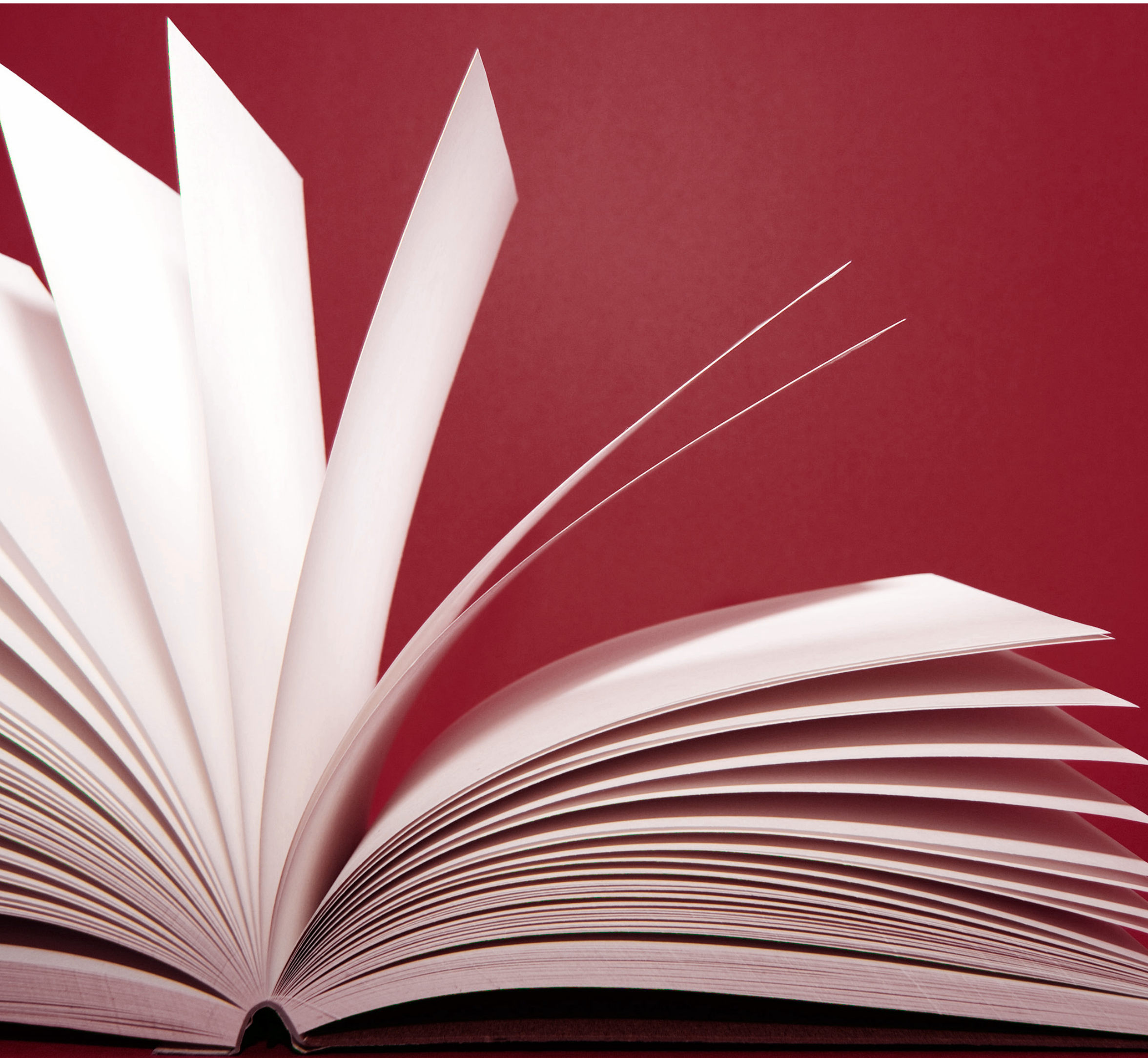
Faculty Spotlight Journal 2012

Fordham Law Communications

FORDHAM LAW

LINCOLN CENTER | NEW YORK CITY

FacultySpotlight
JOURNAL 2012



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FacultySpotlight
JOURNAL 2012

Volume 2 | 2012

Fordham Law School

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FOREWORD

Dear Colleagues:

In this second volume of Fordham Law's Faculty Spotlight Journal, we feature four professors whose scholarship has been recognized with an award or has been named among the best scholarly articles in a particular field of law. These honors and accolades come from other top law schools, leading legal publications, and influential foundations and organizations. Clearly, the important scholarly work of the Law School's talented faculty has caused others to take notice.

Of course, winning an award is not the ultimate measure of the worth of a legal article. All worthy scholarship should confront its readers with difficult questions and complex topics. Legal scholarship, therefore, should engage the lawyers, judges, professors, students, policymakers, officials, and politicians who wrestle with the multifaceted legal issues of the 21st century. The scholarship of the Fordham Law faculty succeeds in this critical engagement. Our professors write timely, compelling articles that question conventional wisdom and eschew easy answers or quick fixes. In other words, Fordham Law professors create great legal scholarship.

The four faculty members in this journal are at the forefront of their respective fields: intellectual property, business and corporate law, and finance law. More than leading scholars, though, they are dedicated professors. Their scholarship is not only found in prominent law reviews; it is also taught in Fordham Law classrooms. In this way, our students learn about pathbreaking scholarship from the scholars themselves. The most favorable recognition of our professors' scholarship, then, comes not from a "Best of" list but rather from the enthusiastic praise of our students.

Michael M. Martin
Dean and University Distinguished Professor of Law

INTRODUCTION

The following pages highlight the scholarship of four Fordham Law faculty members whose incisive legal articles have earned them accolades outside the Fordham Law community. Their work challenges the status quo in their respective fields of business law and intellectual property law. As they continue to trace the ever-evolving contours of contemporary legal thought, they maintain the best traditions of Fordham Law's scholar-teachers.

Jeanne C. Fromer is one of the country's foremost intellectual property law scholars. Her tremendous impact in the field was acknowledged by the American Law Institute when it awarded her one of its two inaugural Young Scholars Medals. Her scholarship exploring the differences between copyright and patent law, as well as the constitutionality of select intellectual property laws, has brilliantly forecast the explosive growth of this increasingly important field of law. In addition to anticipating the critical significance of the intersection between copyright and patent law, her scholarship, including her compelling article "Patentography," proposes unique solutions to longstanding problems in IP law.

Sean J. Griffith's scholarship examines the regulation of business and enterprises and recommends novel ways to improve the regulatory scheme. His trenchant analysis of such sophisticated topics as D&O insurance has situated him as an expert in the field of corporate law. In Griffith's view, the only thing worse than no regulation is feckless regulation; for this reason, he offers nuanced suggestions for certain types of financial institutions to run effectively and with proper accountability.

Sonia Katyal maintains an acute multidisciplinary approach in her scholarship—a keen perspective that deftly melds intellectual property law, technology, and art. Her articles force readers to re-examine basic assumptions of the law as it relates to both established and emerging media. Her findings offer provocative new ways of looking at complex legal situations. For example, her book *Property Outlaws* posits that individuals acting near the margins of the law are responsible for improved legal regulation. Her forthcoming book *Contrabrand* will doubtless burnish her already bright legal reputation.

Richard Squire distills complex finance law topics to their purest essence. In his most recent scholarship, he attacks the hydra of contingent debt to expose a bitter truth: while contingent debt and its accompanying conduct, "correlation-seeking," may benefit shareholders, these behaviors only harm the greater social wealth of the general populace. In uncovering hidden problems within our country's financial system, Squire's critical examination of these byzantine borrowing arrangements may help us avoid other large-scale market disturbances.

Sheila R. Foster

Sheila R. Foster
Vice Dean
Albert A. Walsh '54 Chair in Real Estate, Land Use and Property Law

Jeanne C. Fromer

Today, intellectual property can often be a company's most valuable asset, playing a major role in corporate deals and litigation. The law has adjusted accordingly. Gone are the days when patent, copyright, and trademark were specialized fields whose practitioners rarely tread into other legal domains. With the growth of intellectual property litigation and transactional work, intellectual property spills into several other areas of the law.

Associate Professor Jeanne C. Fromer has witnessed intellectual property's evolution firsthand. Now she stands at the forefront of exploring its development. A graduate of Columbia University, with a B.A. in computer science, and of MIT, where she earned an S.M. in electrical engineering and computer science, Fromer had a natural affinity for law and technology as she pursued her J.D. from Harvard Law School. She went on to work as an attorney at Hale and Dorr LLP, solidifying her specialty in intellectual property. Since joining the Fordham faculty in 2007, she has taught intellectual property while pursuing scholarship that challenges assumed notions of the field. Are certain federal IP laws unconstitutional? Might the different theories justifying intellectual property protection—principally, utilitarianism and deontological thinking—work together in useful harmony? What role does a psychological understanding of creativity have to play in copyright, patent, and trademark law? What does Willy Wonka's chocolate factory have to teach us about trade secrecy?

Her work has drawn the praise of prominent organizations in the field. Two of her articles—"Expressive Incentives in Intellectual Property," forthcoming in the *Virginia Law Review*, and "Claiming Intellectual Property" in the *University of Chicago Law Review*—have been selected for presentation at the prestigious Stanford-Yale Junior Faculty Forum. The 2009 edition of Thomson/West's *Intellectual Property Law Review* included one of her articles, "The Layers of Obviousness in Patent Law" from the *Harvard Journal of Law and Technology*, as one of the best intellectual property articles of 2008. In 2011, the American Law Institute awarded her its inaugural Young Scholars Medal for her scholarship in intellectual property. In particular, "Patentography" in the *New York University Law Review* and "Claiming Intellectual Property" caught the institute's attention.

"Patentography" advocates trying patent cases in the district of the defendant's principal place of business. Not only would this approach control forum shopping for favorable outcomes, but it would also increase the proficiency of the cluster of district courts most likely to hear IP cases about a particular technology or industry. As a result, the U.S. Court of Appeals for the Federal Circuit—the federal appellate court given exclusive jurisdiction over nearly all patent cases—would likely give more credence to the factual findings of the district courts.

With "Claiming Intellectual Property," Fromer questions the rationale for treating patent and copyright law so differently with regard to claiming practice. Whereas patent law protects the characteristics of an invention principally through peripheral claiming by characteristic, copyright law protects the work in a fixed form mainly through central claiming by exemplar. Fromer points out how patent claim drafting can be flexible enough to allow some form of central claiming by characteristic and by exemplar, which makes it easier for the public to know what material it can license and what it can use freely. Copyright law is more complicated. Even though making copyright claiming look more like that in patent law might seem to be a grand improvement, certain key aspects of the copyright system ought to give significant pause before moving in that direction.

Excerpts

Patentography

85 New York University Law Review 1444 (2010)
(excerpted from pages 1445-49, 1486-88, 1496-99, 1503, 1505)

For years, commentators and legislators have criticized the structure and quality of patent litigation. They have three principal complaints. First, they demonstrate that plaintiffs frequently engage in forum shopping in choosing a district court, selecting the district that provides the best strategic advantages to their case. A recent target of this critique is the Eastern District of Texas, which handled nearly thirteen percent of all patent cases in 2008, the highest proportion in the country, in large part due to the perception that it is friendly to patent holders. Forum shopping can be harmful to the legal system by distorting the substantive law, by showcasing the inequities of granting plaintiffs an often outcome-determinative choice among many district courts, and by causing numerous economic inefficiencies, including inconveniences to the parties. This problem has so caught Congress's attention that fixing it has been a mainstay of many of its recent attempts at patent reform.

Second, critics maintain that the district courts are not doing a good job of handling patent litigation. In recent years, the United States Court of Appeals for the Federal Circuit—the appellate court with exclusive jurisdiction over almost all patent appeals—has frequently reversed district court decisions. The Federal Circuit reverses district courts twenty-two percent of the time, a noteworthy figure because the reversal rate for all civil litigation in the federal courts is just over eighteen percent. Federal Circuit reversal rates are even higher for certain critical issues, like claim construction, for which the appellate court reverses district courts almost forty percent of the time. Critics suggest that generalist district court judges lack a grasp both of patent law's intricacies, given how rarely they judge patent cases, and of the technical facts affecting the law's application, as they typically are not experts in patented technologies. Politicians and academics alike have suggested different solutions, including creating specialized patent trial courts, possibly with expert judges, and training some judges in the most patent-heavy district courts in patent law. There are downsides to these solutions, however, including the possibilities of tunnel vision and bias for a specialist court.

Beyond the critiques of district courts' limited factfinding ability, some critics find a (possibly related) third problem in the structure of patent litigation. They argue that the Federal Circuit does not defer frequently enough to the district courts' factual findings and instead, on appeal, reviews their findings de novo—either expressly or while claiming review under a more deferential standard—a task for which the Federal Circuit is not well suited. These critics think that the district courts proficiently evaluate and find facts under at least some circumstances. As such, they conclude that district courts' factual findings ought to be given more credence, particularly given that factual findings are a substantial component of judicial determinations in patent law.

In this Article, I suggest that these three key concerns can all be addressed in substantial part by taking account of patentography—the geography of patent disputes. I propose making patent venue proper only in the district in which the principal place of business of any of a case's defendants is located, with a safety valve to avoid due process concerns, which might occur [for] a minute number [of plaintiffs for whom severe inconvenience of suit leaves them, for all intents and purposes, without any redress for the wrong of patent infringement]. Recent congressional bills constraining patent venue take an advisable step in this direction by making the defendant's principal place of business one of the major categories of venue possibilities, but their rules are inadvisably permissive. Moreover, congressional reformers seem not to appreciate just how efficacious thoughtful venue constraints might be in improving patent litigation beyond merely clamping down on forum shopping.

In addition to nearly eliminating forum shopping, constraining venue as I propose would improve district courts' decisionmaking and encourage the Federal Circuit to defer more appropriately to district courts' factual findings. I argue that these two effects stem from how patent cases would be distributed under my proposal. Although Kimberly Moore (now a judge on the Federal Circuit) and Rochelle Dreyfuss contend that restricting venue choices would too widely disperse patent suits among the nation's district courts, I argue that the opposite would occur because of the clustered nature of patentography. Constricting venue as I propose will tend to group patent cases involving particular technologies or industries in a limited number of districts. Industries tend to cluster around particular geographic centers, such as the pharmaceutical industry in New Jersey and the software industry in Silicon Valley and the Boston and Seattle areas. Consequently, restricting patent venue to the principal place of business of a defendant will lead to a concentration of an industry's patent suits in the districts where that industry's firms are densest. Under my proposed venue rules, pharmaceutical suits will likely cluster in the District of New Jersey and software patent suits will likely group themselves in the Northern District of California, the District of Massachusetts, and the Western District of Washington.

When this clustering occurs, a handful of district courts will adjudicate many patent cases in particular technologies or industries. The resulting proficiency gains will help those courts serve both as skilled factfinders in developing case records and as patent laboratories for tailoring patent law to promote innovation in their particular clustered technologies or industries. In this light, I suggest that arguments to create specialized trial courts for patent law are generally misguided. Patent law needs more accurate, efficient, and thoughtful judicial resolution of controversies not through a set of district courts handling only patent cases, but via generalist district courts that naturally hear clusters of patent cases involving one industry or group of technologies, developing a proficiency in the industry-specific issues that commonly arise. Moreover, local judges' and juries' [typically] elevated familiarity with a district's leading industries would produce better reasoned decisions than would their counterparts in arbitrary locations. As such, my proposal builds on joint work by Dan Burk and Mark Lemley, which suggests that courts can and do tailor patent law to particular technologies or industries, with the aim of providing appropriate incentives to innovate under the particular circumstances of that industry.

Were this clustering effect to obtain, the Federal Circuit, as the exclusive court of appeals for nearly all patent litigation, would then have the advantage of these collected, well-reasoned opinions when reviewing and setting the appropriate patent rules for each industry or technology. Given an improvement in the quality of district court opinions, the Federal Circuit then ought to feel more comfortable granting greater deference to the district courts' many factual findings and could focus its energies on appellate lawmaking, its intended role.

Some might argue that my proposal risks systemic bias or capture in the district courts. For instance, if the district courts in the Northern District of California were to see many software patent cases between local defendants and varying groups of plaintiffs, those courts might come to identify with, or be captured by, the interests of local defendants in software patent cases. If such bias proliferated, it might render individual decisions suspect and prejudice the law in one direction or another.

This problem, however, is less severe than it might seem. Any such bias falls in line with venue generally, which tends to focus on defendants and their convenience. . . . Moreover, to the extent there is bias, [significant evidence indicates that] it already exists in the other direction—toward plaintiffs—under the current structure. . . . Therefore, a shift to requiring suit in the principal place of business of a defendant would merely shift existing structural biases away from the plaintiff to the defendant.

Furthermore, a variety of defendants exist, which should diminish bias. . . . [Additionally], it is thought that a substantial majority of patent cases are between parties working in the same industry, a fact which, if true, would make it harder for district court judges to rule against plaintiffs by crafting industry-specific, defendant-friendly rules.

To [demonstrate the effects of my proposed venue rule], I evaluate empirical data of all utility patent litigation filed in 2005 to compare existing technology-specific clusters of patent suits in the district courts with a simulation of how these suits would hypothetically have clustered under my proposed venue rule. Relying on these comparisons, I demonstrate that more robust and natural technology-specific clusters would form under my proposal.

[To show that my venue rule will lead to the clustering I propose, consider two representative technology-specific segments found in my data. T]here are 579 cases in which at least one of the patents being litigated is for a computer or communications technology. **Figure 1** shows these cases by actual district on a geographic heatmap, while **Figure 2** shows the simulated distribution of the same cases by district under my restrictive venue rule. **Table 1** lists the top ten districts for computer and communication patent cases (under both the actual and hypothetical scenarios) along with the number of cases, the ranking of districts for these cases, and the percentage of total patent cases in each district. The actual distribution shows that there are strong clusters, particularly in the Eastern District of Texas (94 cases), the Northern District of California (64), the Central District of California (47), and the Northern District of Illinois (45). There is a mix of districts in this list: Some are known to be centers of innovation in computers and communications technology—like the Northern District of California—and some are known to host almost no such technology—most pertinently, the Eastern District of Texas, suspected by many to be a popular choice as a plaintiff-friendly haven, particularly for software patentees. By contrast, the hypothetical distribution shows strong clustering effects, although the clusters resulting from forum shopping disappear in this simulation. There are no longer any clusters in the Eastern District of Texas or in the District of Delaware (which had 30 cases under the current rule). In the hypothetical distribution, the clusters are more naturally located in districts hosting substantial swaths of the American software industry: the Northern District of California (98.937), Central District of California (56.798), Northern District of Illinois (39.643), Southern District of New York (32.397), District of New Jersey (28.238), and Western District of Washington (20.075).

[**Figure 3** shows the] actual clusters . . . for . . . earth working and wells patents (33 cases in total) . . . [It] shows actual clustering in the Southern District of Texas, with 7 cases, the Eastern District of Texas, with 4, and the Eastern District of Louisiana, with 3. [**Figure 4**], by contrast, . . . show[s] more intense hypothetical cluster[ing] for th[is] same technolog[y] under my proposed rule. [It] shows extremely dense clustering in the Southern District of Texas, with 14 cases, which ought to be unsurprising given the concentrated presence of the oil industry there.

Relying on theory and the data, I argue that my proposed rule is preferable to the status quo. The simulation's clusters would form naturally without allowing plaintiffs to shop for the most strategically advantageous forum. These natural clusters would also occur in optimal locations. Because a district's judges and juries are drawn from the vicinity of the region's natural industry clusters, they will tend to know more about the cluster of industries nearby and be better situated to evaluate patent scope, validity, infringement, and other issues in the context of what enhances innovation in that industry. These clusters would also be more stable because industry clusters do not often shift geographically in short periods of time, whereas artificial, forum-shopping-based clusters do.

Although this Article is situated in patent law, its reasoning and conclusions extend to other legal fields. For areas of law that share patent law's pertinent characteristics—factual or legal complexities keyed to particular industries—similar venue constraints might be appropriate, the better to take advantage of clustering's salutary effects on accurate adjudication.

Figure 1
Actual Computer & Communication Cases by District (n = 582)

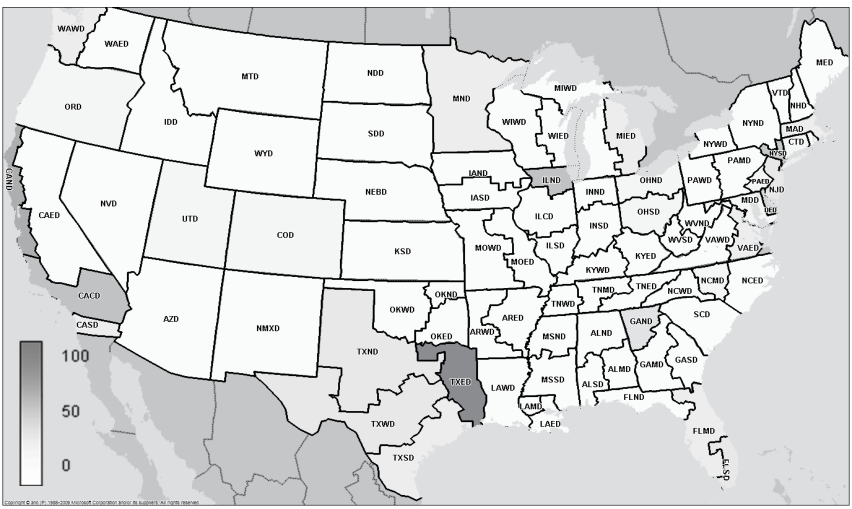

Figure 2
Simulated Computer & Communication Cases by District (n = 582)

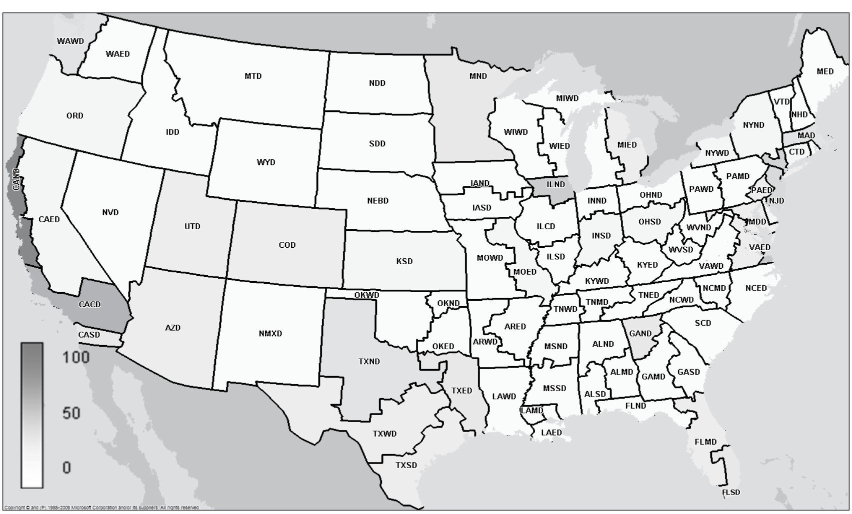

Table 1
Distribution of Computer & Communication Cases Among District Courts

District	Number of Actual Cases	Number of Hypothetical Cases	Actual Ranking	Hypothetical Ranking	Actual Percentage of Computer & Communication Patent Cases	Hypothetical Percentage of Computer & Communication Patent Cases
Eastern District of Texas	94	13.283	1	13	16.2%	2.3%
Northern District of California	64	98.937	2	1	11%	17%
Central District of California	48	57.798	3	2	8.2%	9.9%
Northern District of Illinois	45	39.643	4	3	7.7%	6.8%
Southern District of New York	40	32.397	5	4	6.9%	5.6%
District of Delaware	30	5.1	6	27	5.2%	0.9%
Northern District of Georgia	19	15.987	7	9	3.3%	2.7%
Southern District of Florida	17	15.331	8	11	2.9%	2.6%
Northern District of Texas	16	17.483	9	8	2.7%	3%
District of New Jersey	15	28.238	10	5	2.6%	4.9%
Western District of Texas	15	9.739	10	17	2.6%	1.7%
District of Massachusetts	13	19.274	12	7	2.2%	3.3%
Western District of Washington	11	20.075	13	6	1.9%	3.4%
District of Minnesota	10	15.574	15	10	1.7%	2.7%

Figure 3
Actual Earth Working & Wells Cases by District (n = 33)

Figure 4
Simulated Earth Working & Wells Cases by District
(n = 33)

Claiming Intellectual Property

76 University of Chicago Law Review 719 (2009) (excerpted from pages 720-24)

By writing a series of James Bond novels, Ian Fleming qualified for American copyright protection, pursuant to which works created by others without license and found by courts to be substantially similar to the novels would generally infringe his copyright. Imagine instead that Fleming would have had to draft a claim setting out his novels' essential features, such as "a story featuring a suave male British spy, who frequently wears a tuxedo and has a strong sensual appetite, and detailing his adventures in international intrigue, in which he prevails through use of his quick wit and high-technology gadgets." Dependent claims might further note that the spy introduces himself by his last name followed by his full name ("Bond, James Bond") and that he orders his martinis "shaken, not stirred." Copyright protection would then be premised on the bounds delineated by these claims. Infringement litigation might then need to address how often is "frequently" or whether a film featuring a similar female British character ("Bond, Jane Bond") infringes the copyright.

This hypothetical claiming system looks like that of patent law, under which an invention's bounds must be demarcated as a prerequisite to patent protection. But envision for a moment that patent claiming would look more like that of copyright law. Alexander Graham Bell would receive a patent for his invention of the telephone after having fixed (or perhaps commercialized) it in some form. Assuming the invention complies with the threshold requirements of patent law, the set of protected embodiments would include all substantially similar implementations—a cordless telephone? a fax machine? Internet telephony?—a set to be enumerated on a case-by-case basis in any future infringement litigation, rather than at the time of patenting. This determination would require courts to ascertain the essential properties of a patented invention.

This thought experiment seems to indicate that claiming the set of protected embodiments under patent law looks very different than copyright law. And in a sense, it does. Patent law has adopted a system of peripheral claiming, requiring patentees to articulate their inventions' bounds by the time of the patent grant, usually by listing their necessary and sufficient characteristics. Peripheral claims in patent law are conventionally thought to give notice to the public of the extent of the set of protected embodiments so as to encourage efficient investment in innovation, thereby fostering patent law's overarching goal of stimulating useful innovation by maintaining "the delicate balance between inventors, who rely on the promise of the law to bring the invention forth, and the public, which should be encouraged to pursue innovations, creations, and new ideas beyond the inventor's exclusive rights."[1] And copyright law has implicitly adopted a system of central claiming by exemplar, requiring the articulation only of a prototypical member of the set of protected works—namely, the copyrightable work itself fixed in a tangible form. Copyright protection then extends beyond the exemplar to substantially similar works, a set of works to be enumerated only down the road in case-by-case infringement litigation. Investigating the claiming practices of patent and copyright law side by side thus illuminates two salient axes for claiming intellectual property: peripheral versus central and characteristic versus exemplar. Though scholarship mentions patent law's peripheral claims and Clarisa Long and

1 Festo Corp v Shoketsu Kinzoku Kogyo Kabushiki Co, 535 US 722, 731 (2002).

Henry Smith discuss patent law's claiming requirements and copyright law's lack thereof,[2] until now these dual claiming dimensions have not been expressly appreciated.

Despite patent law's typical peripheral claims by characteristic and copyright law's typical central claims by exemplar, in practice, patent and copyright claiming are each heterogeneous. Patent law retains some vestiges of central claiming under which it used to operate, as evidenced by the doctrine of equivalents, statutory means-plus-function claiming, and dependent claims. And patent law, though usually claiming by characteristic, encourages some claiming by exemplar through its best-mode requirement and Markush claims. By contrast, copyright law, through the approved use of licenses to permit others to make substantially similar works, encourages expression of the bounds of works permissibly created under such licenses and the delineation of characteristic features of the set of protected works. These expressions in legally binding contracts incorporate forms of peripheral claiming and claiming by characteristic into copyright practice.

This Article explores which forms of claiming promote intellectual property's overarching constitutional goal: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[3] It considers how each sort of claiming affects the costs of drafting claims, efficacy of notice to the public of the set of protected embodiments ("content notice"), ascertainment of protectability, breadth of the set of protected works, and ability to defer to the future the decision of whether certain works (typically those that are technologically, commercially, or intellectually unforeseeable) fall within the set of protected works. That the choice of claiming systems implicates in different ways the foregoing factors— factors essential to calibrating intellectual property law to stimulate innovation—underscores the importance of choosing a claiming system with care.

Though previous scholarship principally defends the typical claiming forms for both patent and copyright law, this Article undertakes a thought experiment to analyze whether they are ideal for either type of intellectual property. This task, in fact, is suggested by patent law's incorporation of not insignificant elements of central and exemplar claiming and copyright practice's use of peripheral and characteristic claiming. This Article explores whether claiming in copyright and patent law can learn from one another.

Though patent law admirably incorporates all four types of claiming flexibly, it can be tweaked to stimulate innovation by adding claiming elements more reminiscent of copyright law. I suggest that patent law's typical peripheral claims by characteristic, adopted principally to provide content notice of the set of embodiments protected by a patent, do not provide sufficient notice, which negatively affects assessments of protectability and the operational breadth of the set of protected works. To ameliorate these and other concerns, I propose—contrary to conventional wisdom—that ex ante patent claim drafting be modified to include central claiming by characteristic. And claiming by exemplar ought to serve a role in patent law. Claims by characteristic can be supplemented by rules requiring the registration of certain exemplars—all commercial implementations by the patentee or licensee—claimed to be within the set of protected embodiments. Exemplar registration, which would be available to the public and linked to the associated patent, would help sharpen the understanding of the bounds of the set of protected embodiments. And it would occur in the situations in which exemplars are most useful, when the patented invention is commercialized and is therefore likely to be valuable—when content notice is important. These modifications to patent claiming would better serve

2 See Clarisa Long, *Information Costs in Patent and Copyright*, 90 VA. L. REV. 465, 499-501 (2004) (describing the differences between patent and copyright law with respect to how each handles the information asymmetry between owners and observers); Henry E. Smith, *Intellectual Property As Property: Delineating Entitlements in Information*, 116 YALE L.J. 1742, 1807 (2007) (contrasting copyright and patent claiming rights and the governance regimes generated as a result of those rights).

3 US Const Art I, § 8, cl 8.

patent law's purpose to stimulate innovation by making it easier for the public to distinguish between material that must be licensed to be used and material that can be used freely for follow-up innovation.

Claiming in copyright law is more complicated. On the one hand, the comparative analysis of claiming approaches might seem to suggest that claiming in copyright law would be vastly improved by incorporating aspects more evocative of patent claims. On the other hand, aspects particular to copyright law suggest that such borrowing might not make sense in the copyright system. As it stands, copyright's central claims by exemplar provide little content notice to the public, leading risk-averse third parties either to take licenses even as to works not protected by copyright or to avoid them completely, a situation that grants too heavy a copyright reward at the expense of generating further creativity. In that vein, it might seem far more productive to require or provide significant incentive to copyright claimants ex ante to claim their works centrally by characteristic. This claiming would entail a succinctly expressed pattern of the work at issue. On this view, such claims would provide better ex ante content notice in two ways. First, the enablement of feature-by-feature comparisons could help indicate those works that would be considered to be substantially similar to the created work and thus protected under the copyright. Second, such claims could help explicate which substantially similar works would nonetheless be permissible uses under the doctrine of fair use by encouraging straightforward determinations of works that borrow from the copyrighted work in ways that do not implicate too many of the claimed features or transform it significantly. On the other hand, aspects integral to the copyright system—including its fine line between protecting expression but not ideas, grounded in the First Amendment; societal views on describing the artistic works copyright protects; and the ease of creating copyrightable works—give significant pause to any notion of adopting central claiming by characteristic in copyright.

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Negotiation for Automated Generation of Temporal Multimedia Presentations, Association for Computing Machinery Multimedia 1996 (with Mukesh Dalal, Steven Feiner, Kathleen McKeown, Shimei Pan, Michelle Zhou, Tobias Hollerer, James Shaw, and Yong Feng)

Sean J. Griffith

In a time of financial crisis, how do you keep tabs on industries so they have room to flourish without putting the economy further at risk? The question has attracted a growing audience to the scholarship of **Professor Sean J. Griffith**, T.J. Maloney Chair in Business Law at Fordham Law and leading expert in the regulation of business.

A magna cum laude graduate of Harvard Law School, Griffith honed his specialty in corporate and securities law while working as an associate in the corporate department of Wachtell, Lipton, Rosen & Katz in New York, focusing on public company mergers and acquisitions. Griffith teaches corporate law and governance at Fordham Law, which he joined in 2006.

A three-part series of articles Griffith co-wrote with Tom Baker on how directors' and officers' liability insurance affects corporate governance won multiple "best of the year" plaudits and led to a book, *Ensuring Corporate Misconduct: How Liability Insurance Undermines Shareholder Litigation* (University of Chicago Press, 2010). The book argues that D&O insurance undermines the primary purpose of shareholder lawsuits—to act as a deterrent against corporate malfeasance. The threat of shareholder litigation is supposed to force companies to play by the rules, but D&O insurance lets them transplant that risk to the insurer. This leaves the executive officers free to steer their companies in dangerous directions because they know they won't have to pay the price for potentially disastrous decisions. The D&O insurers themselves don't do as much as they could to hold their clients more accountable, acting more as insulation for bad governance than safeguards against it. Griffith and Baker propose ways that D&O insurers could change the way they do business to keep their corporate clients on the straight and narrow, such as maintaining better control over defense and settlement and monitoring their clients with loss-prevention programs similar to the kind used by other fields of insurance.

In his most recent article, "Governing Systemic Risk: Towards a Governance Structure for Derivatives Clearinghouses" (forthcoming, *Emory Law Journal*, 2012), Griffith suggests that the application of ineffective regulation may be just as detrimental as the absence of it. The article critiques the proposed governing system for derivatives clearing houses and offers a more elegant solution. Created to monitor derivatives trades and build reserves against default, clearinghouses are funded with private capital yet they serve a public purpose. As public-private entities, they can't quite be governed as businesses but can't quite be governed as public-interest institutions either. To run these unique organizations, Griffith proposes a dual governing body modeled after the supervisory boards of German corporations, which have some members who answer to shareholders and others who answer to employees. Griffith's clearinghouse boards would be made up of directors elected by commercial interests that want the clearinghouse to succeed as a business and an equal number of directors elected by public interest to contain risk at the clearinghouse. The two groups would balance each other out and their separate charges of accountability would help assure that neither side oversteps their bounds.

Excerpts

Governing Systemic Risk:
Towards a Governance Structure for Derivatives Clearinghouses

Forthcoming, Emory Law Journal 2012

Introduction

In targeting derivatives for regulatory reform, policy-makers have fastened upon the idea of centralizing counterparty credit risk in a single place, a clearinghouse, where it can be supervised and managed. Clearinghouses are a public-private solution to the problem of systemic risk. Funded with private capital to serve commercial ends as well as the public purpose of containing systemic risk, clearinghouses provide a means for monitoring derivatives trades and, more importantly perhaps, for building reserves against default so that if one party to a derivatives transaction defaults on its contractual obligation, the consequences of the default will be contained within the clearinghouse and not spread throughout the broader financial system. In order for this strategy of containment to work, however, much depends upon how the clearinghouse is governed. Specifically, much depends on how the clearinghouse models the risk of derivatives instruments, what the clearinghouse requires of its members in terms of credit-quality and contributions to collateral and reserve funds, and what products the clearinghouse accepts for clearing. These are core issues of risk management, and they depend ultimately on clearinghouse governance.

Recognizing that clearinghouse governance is critically important for the management of systemic risk, policy-makers have sought to engineer governance structures for clearinghouses. Unfortunately, the policy-makers' proposals have generally failed to address the pervasive free-riding problem underlying clearinghouse governance. Because no private party stands to enjoy a benefit equal to the costs of controlling systemic risk, no private party can be expected fully to internalize these costs. Worse, each of the major commercial interests involved in derivatives clearing faces a moral hazard problem—that is, an incentive to engage in excessive risk taking as a result of the fact that a significant portion of the cost of that party's actions are borne by others. These incentive problems are a fundamental outgrowth of the public-private nature of the clearinghouse.

Derivatives and Systemic Risk

The global financial crisis began when the bubble in the U.S. housing market that had been inflated by a combination of government policy, unscrupulous lending practices, and financial engineering finally burst in 2007. Because the risks of the housing market had been repackaged, split into smaller pieces, and widely distributed, the effects soon spread throughout the entire economy. The financial technology that enabled this risk to spread included, principally, securitization, but also derivatives.

Derivatives contributed to the crisis in two basic ways—the first having to do with the stimulating of the market for the underlying reference asset, in this case subprime mortgages, and the second having to do with the accumulation of counterparty credit risk in large financial institutions.

The regulation of OTC derivatives under Title VII of the Act has three primary goals: (1) the minimization of systemic risk from derivatives trading, (2) the establishment of transparency in derivatives markets, and (3) the creation of credit protection for derivatives counterparties. Moreover, under the statute, each of these basic goals is to be accomplished largely through a single structural innovation—that is, the introduction of central counterparties or "clearinghouses" in derivatives trading. The core idea, in other words, is to move as much OTC derivatives trading as possible onto clearinghouses and, wherever possible, onto exchanges and thus to eliminate, or at least minimize, bilateral trading in favor of centralization.

Starting from the statutory mandate, the regulatory agencies acknowledged the presence of incentive problems on the part of the various commercial parties that might lead to a reduction in clearinghouse access, on the one hand, or to a failure to manage and contain systemic risk, on the other. Noting the potential for conflict between these goals, the regulatory agencies sought to design governance structures that would respond to each problem. The governance structures they propose have two basic foci: voting power and governance. The voting power rules impose a set of caps on clearinghouse members' voting interests, and the governance rules focus on the independence of the clearinghouse board of directors and the composition of certain board committees.

Critiquing the Proposed Rulemaking

Voting Caps

Voting caps conflict with the basic corporate law premise that voting interests should be aligned with ownership interests. This is so because when an investor has voting control that is disproportionate to her ownership interest, she has an incentive to use her voting power to increase her distribution of benefits from the firm at the expense of other owners' proportional interests. The misalignment of ownership and voting, in other words, creates moral hazard.

The moral hazard problem may be especially acute in clearinghouses. Dealers bear by far the greatest amount of risk in clearinghouses. If voting caps function as intended, they will limit the ability of dealers to exert a level of control commensurate with the risk they bear. Instead, non-dealer equity holders, who suffer loss only after the dealer-funded reserves have been exhausted, will enjoy significantly greater control than the amount of risk they bear.

Equity owners who enjoy voting rights in excess of their risk may seek to clear inappropriate instruments or to underweight risk in order to capture additional volume, understanding that they suffer only when losses are large enough to destroy the clearinghouse but they benefit from dollar one of profit.

It is sufficient, therefore, to reject the current voting cap proposals as ineffective.

Independence

The other key component of the regulatory agencies' proposed governance rules is mandatory minimum numbers of independent directors on clearinghouse boards and board committees. That the regulators should seize upon director independence in the clearinghouse context is, in one sense, unsurprising since director independence is, after all, a familiar corporate governance remedy. It has been suggested as the solution to incentive problems arising from the demand requirement in derivative suits, management buyouts, takeover defenses, self-dealing transactions, and perhaps most famously in Sarbanes-Oxley, as a cure for accounting scandals such as those that occurred at Enron and Worldcom. In those contexts, however, independence has a different meaning than it does here. There, and indeed generally in discourse about corporate governance, independence is taken to mean a director who is not also a member of management or controlled by someone else who is. Here, however, independence means, basically, not a large dealer. This is not quite (indeed not nearly) the same idea, and the unintended consequences that this distinction is likely to have on clearinghouse governance is a good reason to reject the attempt to use independence to solve the governance problems of clearinghouses. But it is not the only reason. Another equally good, if not better, reason is that independence simply does not work. There is no good reason to believe that independence solves corporate governance problems generally or that it will solve clearinghouse governance problems in particular.

A New Path

The basic undercurrents of the discussion to this point have been problems of moral hazard and free-riding. A recurring moral hazard problem underlies the incentives of each of the parties most likely to become involved in clearinghouse governance. And the central function of the clearinghouse—that is, the management of systemic risk—has revealed itself to have the character of a public good, leading to a pervasive free-rider problem.

Putting these two insights together, the optimal clearinghouse governance structure would seem to require a separate governing body with a public charge—the containment of systemic risk. Additionally, in order to be rendered accountable to that public interest, the governing body must be appointed directly by electors representing that interest. The optimal clearinghouse governance structure thus would have a dual aspect, guided in part by commercial interests seeking to ensure the sustainability of the clearinghouse from a business perspective, and in part by the public interest in managing systemic risk. These two aspects of clearinghouse governance would interact for the good of the clearinghouse—the failure of either interest dooms both—but their separate foci and separate lines of accountability assure that neither interest absorbs the other.

Co-determination of the supervisory board, found in German corporations, is a structural solution designed to guarantee that German corporations remain accountable to both shareholders and employees. Shareholders vote for shareholder representatives, and employees vote for employee (often union) representatives, an arrangement designed to ensure the accountability of board members to these respective interests. The two sets of interests then work together through their representatives on the supervisory board.

This board structure presents an appealing model for clearinghouse governance because it presents a formal means of guaranteeing accountability, not, in the case of clearinghouses, to employee interests, but rather to the public interest in managing systemic risk. The parallel in the context of clearinghouses would thus be a mechanism for electing board members to render them accountable to the public interest of containing systemic risk rather than the commercial interests underwriting the clearinghouse.

To effectuate this dual board structure, the electors of clearinghouse boards would likewise need to be split into two classes—into the electors of the traditional directors, on the one hand, and the electors of the supervisory directors, on the other. As regards the electors of the traditional directors, because the special requirements of the clearinghouse—that is, the management and control of systemic risk—are to be the central focus of the supervisory directors, there would seem to be no reason to interfere with the basic norm of shareholder primacy in electing the traditional directors. This Article therefore recommends the abandonment of the voting caps and independence requirements recommended by the SEC and the CFTC in favor of a system that allows the traditional directors to be elected by whatever commercial interests come to own the clearinghouse. A consequence of this approach may be that the major dealers come to dominate the traditional directors, but this is not necessarily a negative outcome in light of the importance, described above, in matching control with risk-bearing. Moreover, the supervisory directors would stand as a counterweight to any excesses of traditional directors under the influence of the major dealers.

While some details remain to be specified, the thrust of this Article's proposals should by now be clear. Its central policy recommendation, simply stated, is to establish a separately elected class of directors who will remain accountable to the public interest in clearinghouse governance and whose authority will be generally co-equal with those members of the clearinghouse board elected by the various commercial interests. Understanding that this is not the appropriate forum to pursue a finely tuned body of rules, this Article will recommend simply that the details follow from that basic statement of intent.

Ensuring Corporate Misconduct: How Liability Insurance Undermines Shareholder Litigation

Co-authored with Tom Baker, University of Chicago Press, 2011

Introduction

Shareholder litigation forms an important part of the structure of law and regulation affecting American business. Because public regulators cannot oversee every company at every moment and cannot anticipate or even respond to every report of a potential wrong, a variety of remedies are left in the hands of shareholders themselves. Shareholders who have suffered at the hands of a corporation in which they have invested can sue—either as a class or on behalf of the company itself—to right these wrongs. They thus assume, with their counsel, the role of "private attorneys general," with strong personal incentives to detect and prosecute corporate wrongdoing. The lawsuits they bring fill an important gap in the regulatory framework affecting American business.

Shareholder litigation exerts its regulatory effect through the mechanism of deterrence. That is, prospective wrongdoers realize, through the threat of litigation, that they will be made to account for whatever harms they cause and, thus internalizing the cost of their conduct, forswear bad acts. This basic mechanism of deterrence explains much civil litigation. Corporate officers and directors, understanding that they may be held liable to their investors for the harms they cause, refrain from engaging in conduct that will harm investors and induce them to sue. In this way, shareholder litigation regulates corporate conduct.

The problem with this story in the corporate context is that officers and directors are typically covered under a form of insurance, known as "Directors' and Officers' Liability Insurance" or "D&O insurance," that insulates them from personal liability in the event of shareholder litigation. D&O insurance also protects the corporation itself from liabilities it may have in connection with shareholder litigation. This insurance disrupts the deterrence mechanism by transferring the obligations of the prospective bad actor (the officer, director, or the corporation itself) to a third-party payer (the insurer). An actor that is no longer forced to internalize the costs of its actions is no longer deterred from engaging in harmful conduct—managers who are no longer personally at risk for investor losses are less likely to take care in avoiding them, and corporations that are no longer at risk from shareholder litigation are less likely to monitor the conduct of their managers—and the regulatory effect of shareholder litigation is diminished, distorted, or destroyed.

Unless, that is, the insurer does something to prevent this outcome. The introduction of D&O insurance essentially establishes the D&O insurer as a third-party intermediary in the regulatory dynamic. If shareholder litigation is to deter bad corporate acts, it must be through the intermediary agency of D&O insurers who will have an opportunity to influence corporate conduct through the insurance relationship. Because they are the ones ultimately paying for the harms caused by their corporate insureds, insurers have ample incentive to exert this sort of constraining influence, and they have the means to do so. We identify three ways in which the insurance relationship may influence corporate conduct—through underwriting, monitoring, and the settlement of claims. The question thus becomes what influence D&O insurers do in fact exert through this relationship and whether this influence is sufficient to reintroduce the deterrence mechanism, thus preserving the effectiveness of shareholder litigation as a regulatory device.

Shareholder Litigation

We use the term "shareholder litigation" to encompass all civil actions brought by current or former shareholders of a corporation against the corporation or its managers for losses the shareholders have suffered as a result of actions taken by the corporation or its managers. This definition excludes criminal actions brought by prosecutors or other public authorities as well as enforcement actions brought by regulatory agencies, such as the SEC. It includes, principally, claims brought by shareholders under either federal securities law or state corporate law.

Both types of claims feature shareholders seeking relief from the corporation or its managers for investment loss. Both types of claims principally involve monetary damages, not administrative sanctions or criminal penalties. And both types of claims focus on misconduct by the corporation or its managers leading to losses suffered by shareholders. Not all aspects of these claims are identical. Nevertheless, the claims seem to share the same basic functions, of both compensating shareholders for losses suffered at the hands of the corporation's managers and deterring conduct that might cause such losses in the first place. . . .

Deterrence is widely accepted as the fundamental purpose of shareholder litigation by courts and commentators alike. The U.S. Supreme Court, for example, has long viewed the deterrence effect of private shareholder litigation as "a necessary supplement to [Securities and Exchange] Commission action."

The deterrence function of shareholder litigation connects it to corporate governance. "Corporate governance" is a broad concept that much of the legal literature has given a narrow definition. Scholars discuss it most often in the context of specific regulatory reforms or in terms of charter provisions and other structural characteristics of firms. But corporate governance may refer more broadly to any system of incentives and constraints operating within a firm. Corporate governance is designed to constrain bad acts on the part of corporations and their managers. Insofar as these are the same acts that will lead to liability in shareholder litigation, corporate governance and shareholder litigation pursue similar ends—both seek to make managers better serve the interests of their shareholders. Good corporate governance ought to lead to less shareholder litigation, and the risk of shareholder litigation ought to lead prospective defendants to improve their corporate governance.

If we are thus to take deterrence as the basic rationale behind shareholder litigation, supplying it with its underlying purpose and justifying its existence, we are left primarily with questions about how well shareholder litigation in fact accomplishes the end of deterrence. If shareholder litigation systematically fails to deter, it would fail to accomplish its underlying purpose and would have no reason to exist. Indeed, if shareholder litigation fails to deter, radical reform would seem to be appropriate, either to correct the defects of shareholder litigation or to abolish it altogether.

Introducing Insurance

D&O insurance funds shareholder litigation. Almost every publicly traded corporation in the United States purchases D&O insurance to cover the risk of shareholder litigation. And most shareholder litigation settles within the limits of these policies. D&O insurance transfers shareholder litigation risk away from individual directors and officers and the corporations they manage to third-party insurers.

Our research aims at uncovering the relationship between D&O insurance and corporate governance because, as we have already described, the question of the effectiveness of shareholder litigation as a regulatory device depends upon it. D&O insurance has the potential to insulate corporations and their managers from the consequences of liability rules that are expressly designed to penalize bad governance and encourage good governance. As a result, the D&O insurer thus assumes a pivotal role in the analysis. The question thus becomes, Does the D&O insurer have some means of passing along the deterrent effect of shareholder litigation or does the fact of D&O coverage distort or destroy the accountability mechanisms built into shareholder litigation? In other words, what do D&O insurers do to deter bad acts on the part of their insureds? Since, after all, the insurers are the ones ultimately footing the bill for shareholder claims, they would seem to have ample incentive to control the conduct that might lead to claims.

Research Method

To study the relationship between insurance and shareholder litigation we have used the research tools of qualitative interviews and participant observation that have been employed most effectively in recent years by social scientists outside economics. Following in the footsteps of recent work by sociologists—Richard Ericson, Aaron Doyle, and Dean Barry and earlier work by Carol Heimer—we have sought to illuminate the governance function of insurance, gathering data by interviewing D&O insurance specialists and also by observing and participating in industry conferences on the subject. Our goals were to test our hypotheses about insurance and deterrence as well as simply to learn as much as possible about the role of D&O insurance in shareholder litigation.

The research we report here is the first to systematically explore the relationship between liability and liability insurance through the entire insurance relationship, from underwriting to claims settlement, and to provide a theoretically informed account of the real world impact of this relationship on the particular form of liability that we examine. Thus, our research has both immediate policy relevance for securities regulators and the D&O insurance market and also long-term implications for liability and insurance research.

Roadmap of the Analysis to Come

Our findings show that D&O insurance as it is currently structured significantly undermines the deterrence value of shareholder litigation. Nevertheless, we offer a set of three narrowly tailored solutions that we believe both could and should be enacted in order to improve the regulatory effect of shareholder litigation. . . .

First, because the pricing of D&O insurance may not sufficiently distinguish between good governance risks and bad governance risks to induce poorly governed companies to change their ways, we advocate the mandatory disclosure of D&O policy details in order to signal information to the capital markets that, once incorporated into pricing, may provide additional incentives for corporations to improve their governance.

Second, because significant risk of moral hazard is created by the lack of insurer monitoring and the availability of entity-level coverage, we argued in favor of coinsurance for the corporate protection aspect of D&O insurance coverage in order to give the corporate policyholder more skin in the game and therefore greater incentive to monitor managerial conduct and insist that settlements in securities class actions reflect the merits of the claim.

Third and finally, we recommend additional disclosure of information at settlement—including insurance structure and limits and the extent to which settlement and defense costs are funded by insurance—in order to provide capital market participants with a window into the merits of claims, which they could then incorporate into their valuation of the defendant's shares, thereby inducing prospective defendants to improve their governance quality in order to avoid meritorious claims.

Taken together, we believe that these proposals may serve to reinvigorate the deterrence function of shareholder litigation. This is a critically important goal since deterrence is the raison d'être of shareholder litigation. If shareholder litigation does not deter, then it is, as its critics contend, nothing more than waste. But if we can improve the capacity of shareholder litigation to deter while still protecting individual directors from liability, then we will have accomplished our goal without the dislocating effects of more radical solutions, such as the abolition of shareholder litigation or prohibitions on the purchase of some or all parts of D&O liability insurance. …

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Sonia Katyal

Focused on the overlooked intersection of intellectual property, civil rights, new media, and art, the scholarship of **Professor Sonia Katyal** asks provocative questions that anticipate the future of intellectual property law.

Her most recent book, *Property Outlaws* (Yale University Press, 2010), co-authored with Eduardo Peñalver, explores, in part, how disruptions to new media can alter the balance between law, technology, and property entitlements. The book argues that challenges to the regulation of property and intellectual property law can often, counterintuitively, improve the law by encouraging and protecting innovation and social welfare. Her forthcoming book, *Contrabrand* (Yale University Press, 2012), funded in part by the first grant ever awarded to a law professor by The Creative Capital/Warhol Foundation, studies the complex and controversial relationship among trademark law, advertising, freedom of artistic expression, and brand equity.

A graduate of Brown University and the University of Chicago Law School, Katyal joined Fordham Law in 2002 after specializing in intellectual property litigation at Covington & Burling. She teaches intellectual property, property, and civil rights at the Law School and was appointed Joseph M. McLaughlin Professor of Law in 2011.

Katyal is one of the few young law professors in the country to claim more than four national awards for her scholarly work—including a Warhol Grant, a Yale Cybercrime Award, a Dukeminier Award, and an honorable mention from the American Association of Law Schools. Her scholarship frequently receives accolades for investigating the unexpected exclusions of individuals from property, intellectual property, and civil rights frameworks. "Exporting Identity," Katyal's first major article, published in the *Yale Journal of Law and Feminism*, received a Dukeminier Award from the Williams Institute at UCLA in 2002. The article examines civil rights protections based on sexual orientation from a transnational perspective. The *New York Times Magazine* profiled the next phase of semiotic democracy explored in "Semiotic Disobedience" from the *Washington University Law Review*, and the American Association of Law Schools gave the article an Honorable Mention in its 2006 Scholarly Papers Competition. More recently, Katyal has explored how property frameworks affect the rights of indigenous peoples in a 2008 article published by the *Yale Law Journal*, "In Defense of Property" (co-authored with Kristen Carpenter and Angela Riley). She also continues to do pathbreaking work on trademark theory: Another article published by the *UCLA Law Review*, "Trademark Intersectionality," explores the intersection of race, commercial branding, and advertising.

"Stealth Marketing and Antibranding: The Love that Dare Not Speak Its Name" in the *Buffalo Law Review* was selected by the *Entertainment Publishing and the Arts Handbook* (West, 2011) as one of the best articles in media and entertainment law for 2010. The article looks at how the techniques of antibranding—street art and other stridently non-commercial public forms of expression—have been co-opted as stealth marketing by companies. As this often informal advertising creeps into the public space, websites, and other mass audience channels, the line between brand and antibrand blurs. In the resultant ambiguous liminal space, companies employing stealth marketing resort more frequently to trademark surveillance and cease-and-desist strategies to protect their brands.

Following a similar vein, "Privacy vs. Piracy" from the *Yale Journal of Law and Technology* addresses the implications of the nearly unfettered piracy surveillance and copyright enforcement tools that the law grants online companies. The paper, which won the Yale Cybercrime Award in 2004, describes how intellectual property rights online have changed from a defensive shield to an offensive weapon that tracks consumers and enforces standards of use and expression. If the laws can't be changed to monitor the monitors and restore a balance between protecting copyright and civil liberties online, a small handful of people could turn the Internet into a regime that controls the actions of all future creators—whether their cultural products are legitimate or not.

Excerpts

Stealth Marketing and Antibranding: The Love that Dare Not Speak Its Name

58 Buffalo Law Review 795 (2010)

"In the twenty-first century," one commentator notes, "brands have acquired a place in the world unimaginable in any previous period of history."[1] Consumers, too, have fallen in love with the brand. Brands permeate the fabric of our lives—they help construct our identities, our expressions, our desires, and our language. Yet inasmuch as they serve as powerful expressions of consumer identity and desire, they are also an important vessel of corporate identity and property.

By inhabiting these two worlds—the world of the consumer, and the world of the corporation—brands have come to play an increasingly vexing role in public consciousness. On one hand, they represent a proprietary vessel, a trade symbol that allows a company to symbolically encapsulate its identity—its goals, its products, and, increasingly, its philosophy. Yet on the other hand, brands are also becoming an expressive index of consumer identity and philosophy. Branding offers us a curious transformation of the corporate to the personal; it offers individuals a way to express certain identities, preferences, and passions symbolically: some wear Adidas and Nike shoes because they favor an active, athletic, physically competitive lifestyle, along with the philosophy of competitive living; others dress themselves in Prada's subtle shades to suggest a demure, classic, sophisticated presence. These associations are tightly socially constructed through advertising, but they are also images that are malleable and easily changed.

Further, at the same time that brands are expressive, they are also powerful devices of economic power and market dominance, a factor which leads to potent struggles over their meaning and definition. For, aside from the idealized convergence between personal and corporate identity that a brand represents, a brand can be also simultaneously deeply political and deeply commercial, and as part of our cultural consciousness, a brand can often serve as a powerful organizing principle for political action. In just the last few decades, a new movement of activists has sprung up internationally and domestically, engaging in artistic and political activity to challenge the expansion of the brand into public discourse. Some types of "antibranding" seek to retake public space for their own expression, using graffiti and street art to dissent from the commercialization of the public sphere; some seek to simply rebrand or recode existing brands for the purposes of humor or social commentary. Sometimes antibrands might target a certain brand for opposition; at other times, they might utilize a brand for the purposes of satirical or humorous commentary on another subject. And yet, the ways in which these artists have done so have raised complicated questions of identity, language, and control— setting up a clash between the First Amendment and intellectual property.

1 THE EXPRESSIVE ORGANIZATION: LINKING IDENTITY, REPUTATION, AND THE CORPORATE BRAND 52 (Majken Shultz et al. eds., 2000).

Admittedly, antibrands highlight a critical disjunction between the economic rationale of the marketplace and freedom of speech, and the regulatory, mediating role played by law. But today a major shift has taken place within the spheres inhabited by the brand and the antibrand, respectively. For many years, the brand and the antibrand peacefully coexisted, and most consumers were largely able to identify both by drawing upon context, in both the worlds of real and digital space. However, more recently as consumers have grown more and more overloaded with information, advertisers have been forced to seek out more creative ways to communicate their messages to the public, leading to a blurring of the lines between commercial and non-commercial forms of expression.

While most of us who live in urban landscapes are familiar with the recognizable dialogue offered by branding and antibranding, the increasing prevalence of guerrilla or stealth marketing has tended to blur the lines between traditional and nontraditional forms of advertising. Now, many stealth or guerrilla advertisements employ product placement, word-of-mouth marketing, and user-generated content, often employing self-mocking humor in the process, transforming the world of advertising as a result. Normally, the blurring of boundaries between product placement and parody might be considered unproblematic from a viewer's perspective. One might ask, what's wrong with a little humor in advertising, however subtle the advertising might be? But the crossing of borders between parody and marketing—particularly regarding user-generated content and advertising messages that mimic its style and presentation—has presented particular challenges for lawyers, who must navigate the boundaries between non-commercial speech (usually the sphere of parody or an antibrand) and commercial speech (traditionally the sphere occupied by advertising).

A difficult set of legal issues stem from the crossover between stealth marketing and user generated content in both real and digital space. Today, branding opportunities can be cloaked within ordinary noncommercial expression, as corporate sponsorship extends further and further toward resembling user generated content, making it difficult to discern when content is sponsored and when it is not. Since many forms of stealth marketing often takes place within the nontraditional channels that antibranding occupies (public space, websites, and other forms of media and content), it becomes more difficult then for the consumer to distinguish between the brand and the antibrand, destabilizing the division between them. This shift carries substantial legal implications for trademark owners. When advertising is no longer limited to its traditional channels, the public sphere becomes littered with examples of both branding and antibranding. As a result, it becomes all the more necessary for trademark law to intervene, leading brand managers to act more readily to protect the goodwill behind their marks through an increasing reliance on trademark surveillance and cease-and-desist strategies.

I. The Rise of the Brand

In 1999, a *Financial Times* article prominently displayed a heading that said, "Ford to Outsource Important Parts of Car Assembly."[2] The article quoted a high-ranking executive who predicted that "[t]he manufacture of cars will be a declining part of Ford's business." He announced that Ford would instead "concentrate in the future on design, branding, marketing, sales, and service operations."[3]

It is difficult to underestimate the historical significance of this shift, given Ford's powerful role in the manufacturing industry in the United States. Rather than manufacturing cars, as Ford has done for so long, the announcement declares that Ford will simply engage in branding instead. Since the rise of the Industrial

2 Tim Burt, Ford to Outsource Important Parts of Car Assembly, FIN. TIMES, Dec. 10, 1999, at 1; see also THE EXPRESSIVE ORGANIZATION, supra note 1, at 51.

3 Burt, supra note 2, at 1; see also THE EXPRESSIVE ORGANIZATION, supra note 1, at 51.

Revolution, and for many of the last several decades, Ford Motor Company symbolized the victory of American invention over the uncertainties created by economic and political challenges. The success of Ford Motor Company marked a new path for industry—for the economy, for America—to follow. Now, almost several decades after that fateful moment when the first Ford car left its manufacturing plant, it appears that the American economy has steadfastly grown to value the Ford symbol—the brand—over the function of the original product. There has been much ink spilled on the dangers of Ford's strategy of outsourcing for the American economy, but none on the impact of its switch to a branding factory.

The Ford story typifies the power of the brand. A brand is usually thought to be synonymous with trademarks and trade symbols, comprising an important and valuable component of a corporation's intellectual property portfolio. Here, the economic and the semiotic spheres of language delineate the specific role that brands play in the parallel marketplaces of both goods and speech. In the past, a brand played a relatively limited role in marketing: it served to merely identify and distinguish a certain product. Today, however, the corporate branding strategy has both magnified and amplified these functions by reversing the function of a trademark. In other words, instead of serving as a product identifier, branding strategies today make the trademark— and the cultural identities associated with the mark—the product itself. This inversion between product and trademark is precisely what gives rise to the Ford narrative explored above—companies no longer focus on the product, but its brand instead.

A complex matrix of meanings, products, and identities constitutes the essence of a brand. Yet this "essence," so difficult to define and to pin down, is also the very thing that constructs a brand as both a commodity, as well as a sign of expressive significance. Indeed, the most successful brands enable a triadic convergence of sign, self, and corporate identity. And intellectual property law, too, plays an intimate role in enabling this convergence: corporate branding strategies focus specifically on the creation and propagation of trademarks through advertising. In this way, trademarks have become part of not only an economic market, but also a metaphorical market because they involve— and propagate—a system of using signs to control meaning and language. In this sense, therefore, brands are economic, expressive, and identificative at the same time—for both the consumer, as well as the corporation.

How did this happen? The story here begins, at the end of the nineteenth century, when the corporate world was ensconced in an identity crisis. Despite the 1886 case of *Santa Clara County v. Southern Pacific Railroad*, in which the Supreme Court endowed the business corporation with the legal status of "person" under the Fourteenth Amendment, corporations were largely regarded in the public eye as "soulless" entities, bereft of a definable essence or personality. As the giant business corporation became a permanently transfixed entity on the American business landscape, it became the very symbol of impersonality and diffidence. Thus, corporations became increasingly aware of a massive need for public respect and social recognition. Public perception of "corporate soullessness" involved a perceived lack of conscience on the part of the corporation, coupled with the immense power, efficiency, and profit that large-scale companies represented.

The public perception of a corporation as a cold, impenetrable entity created a need for corporate redefinition. Across the board, corporations had to overcome these perceptions in order to become a definable personality, in order to attain and to communicate a sense of internal vitality to its employees, and to the general public. Part of this strategy focused on advertising as the central and most powerful way to alter this perception. Entrepreneurs began to infuse advertising with their image and personality, almost as if they were running for office: Henry Ford participated in automobile races; legendary *803 shoe manufacturer W.L. Douglas published ads in national magazines emblazoning his picture; King Gillette placed his clean-shaven personage on his ads; the Smith brothers placed their likenesses on boxes of cough drops. In the early

1900s, the increased use of colors, simple logos, letterheads, and even depictions of the corporate factory all helped to suggest an image of an entity that constituted the sum total of the living, breathing individuals that worked within its auspices, rather than a cold, monolithic entity.

At the very same time, corporate branding began to develop. Earlier, brands were largely synonymous with particular products, usually home products, including soap, jam, toothpaste, and breakfast cereals. Most companies during this early period used advertising that appealed to one's rational considerations: the written text of an advertisement, for example, offered an in-depth justification for a product's use coupled with little suggestive imagery, and ads comprehensively detailed the good's superior quality, attributes, and performance. Because publishers tended to require that advertisement submissions conform to a rigid, dual-column format, advertising was mostly limited to specific drafting of language, rather than the uses of symbols and dramatic imagery to describe a product. However, in the latter part of the nineteenth century, magazines, increasingly, became more and more dominant carriers of advertising, leading to a transition from verbal to visual styles of advertising. Agencies, rather than manufacturers themselves, became increasingly saddled with the responsibility of creating a particular essence, or identity, around the product in order to differentiate it from its competition. Advertising began to rely on an increasingly common array of symbols, slogans, poetry, testimonials, coupons, contests, stars, and humor. As a result, the advertising agency attained a newfound prominence as the vehicle by which home products became not only marketed, but personified as well.

Today, branding strategies make up a significant portion of general corporate strategy; financial analysts claim that brand equity makes up a tremendous amount of company value. At times, a company's brand equity has been more important than the book value ascribed to a particular product. Unlike the actual product, which is something with a functional purpose, a brand offers something in addition, an "added value" that consumers value enough to purchase. This 'brand value' or 'brand equity' is precarious and complex, comprising a host of tangible—and legally protectable—qualities such as physical appearance, packaging, design. On a more complex level, however, a brand also encompasses a host of intangible qualities, such as consumer attitudes toward the manufacturing company, or beliefs about the brand in relationship to one's self and others. Increasingly, the intangibility of the latter has become a primary vehicle in building brand equity. Here, a brand encapsulates much more than a tangible product or trade symbol, logo, or name—it encapsulates the critical essence of a corporation—its products, its employees, and, increasingly, its consumers. It is this ephemeral added value that constitutes the value of a brand—its intangible essence.

Privacy v. Piracy

7 Yale Journal of Law and Technology 222 (2004-2005)

Nearly twenty years ago, in a casual footnote at the end of an important essay, renowned property scholar Charles Donahue drew a distinction between "property as a sword," and "property as a shield."[1] Donahue's distinction symbolized an important difference between two facets of the institution—as well as the execution—of property rights; suggesting that property rights can be used for both defensive and offensive purposes in relationships with third parties.

Today, Donahue's distinction offers us a rich metaphor for understanding the transformation that has taken place in the digital era, particularly with respect to the relationship between intellectual property and privacy in cyberspace. As is now clear, the Internet is no longer a smooth-functioning patchwork of anonymous communication between peers. Instead, lurking behind the façade of such potential connections lies an increasing and subtle host of opportunities for legal accountability and detection, particularly where the use (or misuse) of intellectual property is concerned. The result, this paper argues, heralds an important shift in property rights in the digital era: compared to real space, where property rights tended to serve as a shield from harm, property rights in cyberspace serve to form the basis for a host of potentially offensive strategies that have deleterious implications for privacy, anonymity, and freedom of expression.

In recent months, strategies of copyright enforcement have rapidly multiplied, each strategy more invasive than the last. Today, the Recording Industry Association of America (RIAA) and other copyright owners maintain automated Web crawlers that regularly survey and record the Internet Protocol addresses of computers that trade files on peer-to-peer networks. After the RIAA's initial victories, hundreds of subpoenas were issued— sometimes numbering seventy-five per day—each unveiling the digital identities of various Internet subscribers. Schools, responding to threats from the recording industry, have implemented programs that track and report the exchange of copyrighted files. A few have even decided to audit and actively monitor files traded by their students, at the RIAA's request. And in recent sessions, there were proposals before Congress that placed intellectual property owners in a virtually unrestrained position of authority over ordinary consumers and intermediaries. The latest of these, the Protecting Intellectual Property Rights Against Theft and Expropriation (PIRATE) Act, sought to lower the burden of proof to impose criminal penalties on individuals that engaged in acts of file-sharing, including sentences of up to 10 years.

All of these different strategies share one thing in common: they rely on, invariably, private mechanisms of surveillance for their execution and control. And these techniques of surveillance—whether instituted by private entities, or public law enforcement—demonstrate copyright's increasingly tenuous relationship with information privacy. In the past, legislators and scholars have focused their attention on other, more visible methods of surveillance relating to employment, marketing, and national security. This paper, however, explores the phenomenon of "piracy surveillance," an emerging area that is completely distinct from these other modes of consumer monitoring, and is incompletely theorized, technologically unbounded, and, potentially, legally unrestrained. As I will show, recent developments in copyright law—in particular, the DMCA—have invited intellectual property owners to create extrajudicial systems of monitoring and enforcement that detect, deter, and control acts of consumer infringement. As a result, this paper argues that intellectual property rights have been fundamentally altered—from a defensive shield into an offensively oriented

1 Charles Donahue, Jr., The Future of the Concept of Property Predicated From its Past, in PROPERTY 28, 67-8 n.104 (J. Roland Pennock & John W. Chapman eds., 1980).

type of weapon that can be used by intellectual property creators to record the activities of their consumers, and also to enforce particular standards of use and expression, proscribing activities that they deem unacceptable.

This outcome is not solely attributable to the development of peer-to-peer technologies, or the explosion of piracy in cyberspace, as some might suggest. Rather, the outcome involves the comparatively more subtle failure of law to resolve the troubling and often rivalrous relationship between the protection of intellectual property and privacy in cyberspace. The irony, of course, is that both areas of law are facing enormous challenges because of technology's ever-expanding pace of development. Yet, while both areas of law have enormously rich and well-developed areas of scholarly work and analysis, their interactions, particularly across the Internet, have been underappreciated by scholars. Today, however, they are on a collision course that cannot be overlooked much longer, sparked by two major developments in digital space: the rise of consumer surveillance, and the problem of rampant piracy.

The motivation behind piracy surveillance may lie in the protection of copyrighted works, a laudable goal, but the end result, I shall argue, sacrifices the most valuable aspects of cyberspace itself, eviscerating principles of informational privacy for the sake of unlimited control over intellectual property. While some intellectual property owners might herald the development of protective frameworks for intellectual property owners, I argue that it destabilizes a critical balance between privacy, property, and expression. For the new piracy surveillance exposes the paradoxical nature of the Internet: it offers both the consumer and creator a seemingly endless capacity for human expression—a virtual marketplace of ideas—alongside an insurmountable array of capacities for panoptic surveillance. As a result, the Internet both enables and silences speech, often simultaneously.

The goals of this paper are threefold: first, to trace the origins of piracy surveillance though recent jurisprudence involving copyright; second, to provide an analysis of the tradeoffs between public and private modes of piracy surveillance; and third, to suggest the necessity for the law to restore a balance between the protection of copyright and civil liberties in cyberspace. As I will show, piracy surveillance has inverted the relationship between privacy and property, subordinating the protection of privacy to the protection of property. This has occurred in two basic ways: first, piracy surveillance enables copyright owners to utilize a type of monitoring that demonstrably trespasses on a person's expectations of informational privacy and anonymity; and second, the use of piracy surveillance strategies, without conventional substantive and procedural due process constraints, has a harmful tendency to chill free expression in cyberspace.

In the first section of this paper, I review some basic principles of the relationship between privacy and property in real space, and then apply them to cyberspace. I begin by surmising some of the basic assumptions that are both descriptively and aspirationally present in property ownership, and then argue that the architecture of cyberspace has destabilized the preexisting balance between privacy and property by eliminating the material conditions that permit the exercise of spatial privacy. Unlike property ownership in real space, which presupposes a degree of privacy by virtue of material seclusion, the public and private nature of property in cyberspace—coupled with its immense digital mobility and decentralization—often come into conflict with one another, interacting within a sphere of confusing uncertainty. Instead of material seclusion, individuals operate under an assumption of anonymity, which significantly expands their expressive potential in cyberspace. At the same time, however, information harvesting is rampant, a factor which alters any presumption of balance between privacy and property in cyberspace.

Nowhere is this better illustrated than in the context of peer-to-peer transmissions. Here, I describe how peer-to-peer transmissions have enabled the rapid transmission of content, such as music, film and other types of copyrighted material, facilitating a crisis of intellectual property. But it has also created a sort of crisis for privacy and security, as well. By making one's online activities, identities, and preferences transparently visible, peer-to-peer frameworks create a culture of panopticism by other individuals. This culture of panopticism, in turn, enables a variety of entities—government, private individuals, and copyright owners—to exploit the power of peer-to-peer frameworks to develop an increasingly invasive system of surveillance to guard against piracy.

In the second section, I turn to the origins of piracy surveillance, and describe the myriad ways in which private entities have successfully monitored transmissions in cyberspace to control uses of their copyrighted materials. Following the DMCA, I argue, court opinions have unwittingly facilitated the creation of a private regime wherein copyright owners and intermediaries engage in self-help surveillance of consumers. Piracy surveillance regimes take on three basic types, each displaying varying degrees of unilateral aggression: *monitoring*, which involves the use of automated systems to search for protected material; *management*, which involves a host of actions taken in real space and cyberspace to limit certain uses of cultural products; and *interference*, which involves a degree of preventative actions taken to prevent peer-to-peer file-sharing from occurring.

In the third section, I assess the costs and benefits of such regimes, and argue that current, private regimes of copyright enforcement carry significant disadvantages, among them the potential to transform copyright law into a regime of "panoptic publication," where future creators are essentially monitored by third parties for the infringing potential of their activities. Regimes of panoptic publication have especially deleterious (indeed chilling) effects on creations that rely on fair use for their validity, particularly transformative works. As I will show, piracy surveillance carries the potential to transform the nature of copyright from a liability-based regime into a regime that governs the creation of *all* cultural products in cyberspace, both illegitimate and legitimate. This affects both speaker and audience in three primary ways: first, piracy surveillance enables ISPs to monitor and record the activities of their subscribers, thereby affecting the autonomy, anonymity, and privacy individuals enjoy in cyberspace; second, piracy surveillance overdeters copyright infringement, affecting both the expression and fair use of non-offenders; and third, piracy surveillance affects the audience's ability to access information without interference.

This paper takes the view that this conflict between privacy and piracy is important not just because it showcases a new, overlooked mode of surveillance, but also because it demonstrates the need to resolve conflicts between them in ways that are reflective—and protective—of the relationship between modern technology and personal freedoms. I conclude, therefore, by pointing out the need for greater public oversight over these private realms of surveillance, and suggest a number of ways in which we can envision a more protective sphere for individual autonomy in cyberspace. Towards that end, Part IV argues for greater judicial supervision over the DMCA and offers a potential solution that is derived from the Privacy Protection Act and that balances protections for freedom of speech and privacy with the interests of law enforcement.

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Richard Squire

Lawmakers and scholars have traced and retraced the cracks that spread through the economy and caused the financial crisis. But finding the fault lines that portend future fractures takes the keen eye of an expert like **Associate Professor Richard Squire**.

Before joining the Fordham faculty in 2006, Squire obtained a J.D. from Harvard Law School and, in the same year, an M.B.A. from Harvard Business School. He then worked as an associate in the litigation department at Wachtell, Lipton, Rosen & Katz. At Fordham he currently teaches Corporations and Corporate Reorganization and Restructuring. In his recent article "Shareholder Opportunism in a World of Risky Debt," Squire homes in on how certain debt arrangements should be regulated by lawmakers to avert another financial catastrophe. The article was published in the *Harvard Law Review* and was recognized as one of the top 10 corporate and securities law articles of 2010 by the *Corporate Practice Commentator*. The article showcases Squire's ability to identify fundamental problems overlooked by other scholars.

The problem, in this case, is opportunism. Squire first describes the context: with growing frequency, the financial world uses derivatives and similar contracts to create contingent debts that are paid only when uncertain future events take place. The natural incentive for a firm's managers is to sell contingent claims against the firm that are likely to be triggered only in future states of the world in which the firm will be insolvent anyway. Doing this ensures that the burden of the claims is borne by the firm's general creditors rather than its shareholders. Thus, firms have a motive to take on contingent debts that are positively correlated with the firm's insolvency risk. An example of such "correlation-seeking" conduct would be selling credit default swaps on mortgage-backed securities at the same time that the firm purchases such securities for its own portfolio, which was what insurance giant AIG did in the years preceding its 2008 meltdown. While correlation-seeking may enrich shareholders, it destroys social wealth through a host of social costs that include overinvestment, higher borrowing costs, financial distress, and potential systemic risk.

In his earlier article "The Case for Symmetry in Creditors' Rights," published in the *Yale Law Journal*, Squire again uncovers a hidden problem with various types of borrowing arrangements. This time, his focus is secured loans, American general partnerships, and guarantee contracts. Squire makes the case that these widely used arrangements, which he calls asymmetrical, give some creditors an absolute advantage over others in the division of a debtor's assets. On the flipside, symmetrical arrangements such as the corporation and common-law partnership give no one an absolute advantage, as they deliver a prior claim on a distinct asset pool to each creditor group. The symmetrical approach reduces debt appraisal costs, makes creditor monitoring more efficient, and speeds up bankruptcy proceedings. In another key improvement, symmetrical arrangements are not as likely to exploit creditors such as tort victims who do not adjust to subordination of their claims.

Squire proposes reform that would turn secured loans and other asymmetrical arrangements into symmetrical devices for creating social wealth instead of transferring it. In the current, fragile economic climate, Squire's proposal might be the exact type of symmetry that both creditors and debtors need.

Excerpts

Shareholder Opportunism in a World of Risky Debt

123 Harvard Law Review 1151 (2010)

In 2005, near the peak of the recent housing bubble, derivatives traders at AIG were making money hand-over-fist by selling credit default swaps linked to subprime mortgages. This in itself is not surprising: AIG is an insurance company, and a credit default swap in essence is an insurance policy on a bond or other debt obligation. What *is* startling is that AIG at the same time was buying up mortgage-backed securities in its own investment portfolio. This meant that the risks borne by the company were correlated: its assets were likely to plunge in value just as deep liability on its swaps was triggered. When the housing market collapsed, the combined damage to both sides of AIG's balance sheet was more than enough to sink the company.

This Article explains why seemingly reckless conduct of this type can in fact be fully rational from the perspective of shareholders. Such conduct reflects an opportunism hazard presented by contingent debt, a hazard that is here termed *correlation-seeking.* If a firm's contingent debts are especially likely to be triggered when the firm is insolvent, the debt contracts transfer value from the firm's unsecured creditors to its shareholders. This transfer creates an incentive for a firm's managers to sell contingent claims against their firm that correlate—or that through asset purchases can be made to correlate—with the firm's insolvency risk.

How Correlation Determines the Impact of a Contingent Debt

A debt is *contingent* if it becomes payable only upon the occurrence of an uncertain future event, known as the *triggering event.* A wide variety of financial contracts create contingent debts, including guarantees, options and credit default swaps. In each case, the debtor (the firm liable if the contingency occurs) receives one or more up-front payments, known collectively as the *premium.* In exchange, the debtor agrees to pay the claimant (the other party to the contract) a specified amount—known as the contract's *face value*—if the triggering event comes to pass.

Contingent debts can serve socially valuable purposes. Many contingent debt contracts act as insurance policies on investments, and in that role they can be value-creating if the debtor is better positioned than the claimant to bear the downside risk on the investment.

Contingent debt contracts can, however, serve a less benign function: to enrich the shareholders of the debtor at the expense of the debtor's unsecured creditors. To see how this could occur, imagine a hypothetical contingent debt contract which provides that the debtor will be obligated to make a payment to the claimant if and only if the debtor falls insolvent. Under such an arrangement, the debtor's shareholders enjoy the benefits but bear none of the risk. If the debtor remains solvent, the contract expires without the debt's being triggered, and the shareholders' equity stake is enhanced by the amount of the premium. And if the debtor falls insolvent, the triggering of the contingent debt makes no difference to the shareholders, whose equity stake is wiped out anyway. Rather, the triggered liability is borne by the debtor's unsecured creditors because it dilutes their recoveries from the debtor's bankrupt estate.[1] In other words, such a contract constructs a perfect "heads we win, tails you lose" relationship between the debtor's shareholders and unsecured creditors.

In reality, a court would likely refuse to enforce a contract that explicitly required a firm to make a payment only if the firm fell insolvent.[2] However firms can—and often do—achieve an economically equivalent result by engaging in *correlation-seeking.* That is, firms can incur contingent debt that correlates, or that through asset purchases can be made to correlate, with their insolvency risk. And except in the extreme case of a contract that expressly defines the triggering event as the debtor's insolvency, there is little that prohibits correlation-seeking under current law.

Correlation-seeking can take two general forms. The first, which might be called the "forward" type, occurs when a firm's managers sell a contingent claim against the firm that would be triggered only in circumstances when the firm would likely be insolvent. An example would be when a parent corporation issues a guarantee on a loan taken out by its subsidiary. If the parent's largest asset is its equity stake in the subsidiary, the insolvency of the subsidiary would probably cause the parent to fail as well. Therefore, the guarantee on the subsidiary's loan creates a contingent liability that the parent's shareholders, as contrasted with its unsecured creditors, will almost never have to bear. And the second, or "reverse," type of correlation-seeking occurs when a firm incurs contingent debt and then purchases assets that are especially likely to lose value at the same time the debt is triggered. A dramatic recent example is provided by AIG, which incurred large contingent liabilities by selling credit default swaps on subprime mortgage–backed securities, and then bought up subprime securities in its own investment portfolio. These asset purchases made it likely that AIG would be insolvent if liability on its credit default swaps was ever triggered.

Regardless of whether correlation-seeking is of the forward or reverse type, the result is the same: a value transfer from the debtor's unsecured creditors to its shareholders. The transfer occurs when the contingent debt is incurred, or—in the case of reverse correlation-seeking—when the firm purchases the correlated assets. And it consists of a decrease in the creditors' expected recoveries and a corresponding increase in the value of shareholder equity. Though rational from the perspective of shareholders, correlation-seeking will often be wealth-destroying from a social perspective. This is because the opportunity for shareholders to expropriate wealth from creditors distorts a firm's borrowing and investment decisions, leading to overinvestment, higher borrowing costs, financial distress, and potential systemic risk. Firms that seek to transfer wealth end up destroying wealth.

Besides forcing them to shoulder more risk, a positive internal correlation can harm the unsecured creditors in a second way: it can shrink the premium. An increase in the "perceived" internal correlation—meaning the internal correlation that is evident to the claimant at the time of contracting—reduces the claimant's willingness to pay. And a reduction in the premium harms the unsecured creditors by shrinking the pool of assets available to them in the debtor's bankruptcy proceeding. A positive internal correlation thus can land

1 For a firm's unsecured creditors to bear the full brunt of a contingent debt that is triggered when the firm is insolvent, the firm's equity investors must enjoy limited liability, which is why those investors are referred to here as "shareholders," implying a corporation. But limited liability is a feature of most of the other widely used modern business entities, including the limited liability company, limited liability partnership, and Delaware statutory trust. See Henry Hansmann, Reinier Kraakman & Richard Squire, Law and the Rise of the Firm, 119 HARV. L. REV. 1333, 1397 (2006). Only the common law partnership continues to hold equity investors fully liable for firm debts.

2 One possibility is that a court would deem this hypothetical contract an improper "ipso facto" arrangement. Provisions of the Bankruptcy Code deny enforcement of ipso facto clauses in specific contexts. Alternatively, a court might deem the contract a deliberate fraudulent transfer.

a one-two punch on the unsecured creditors: it increases the likelihood that, if the debtor falls insolvent, they will have to share the debtor's assets with the claimant; and it can decrease the value of those assets by causing the claimant to pay a smaller premium.

Why would a firm's unsecured creditors permit its managers to engage in correlation-seeking? While opportunism of this type is not illegal as a matter of positive law, creditors in theory could negotiate loan covenants that prohibit it. As a practical matter, however, this approach will often not be cost- effective. Loan covenants will deter opportunism only if the creditors monitor the debtor for violations, as opportunism will otherwise be evident only after the debtor has fallen insolvent, at which point an enforcement action is ineffective because the debtor is judgment-proof. And for many creditors, especially those with relatively small claims, the necessary monitoring costs will exceed the expected losses that the monitoring would prevent.[3] Thus, rather than monitor, many creditors will simply factor opportunism risk into the interest rate they demand up front from all debtors, a response that does not deter opportunism because the debtor pays the same interest rate regardless of how it treats its creditors after it borrows.[4] Finally, creditors will not bother to monitor if they believe that the government will bail them out if their debtor fails. Bailouts shift the loss produced by correlation-seeking from the debtor's unsecured creditors to another group of "creditors": taxpayers. And the correlation-seeking hazard will be at its zenith when creditors lack incentive to monitor, an observation of obvious importance as lawmakers continue to craft a response to the 2008 financial crisis.

For these reasons, correlation-seeking makes shareholders richer. Surprisingly, it usually also makes them *safer*. In this way, correlation-seeking stands in stark contrast to other forms of shareholder opportunism that scholars have studied. For example, higher leverage can enrich shareholders by increasing the degree to which creditors bear losses caused by declining asset values. But while higher leverage increases expected shareholder returns, it also raises the volatility of those returns, an unpleasant side effect for risk-averse shareholders. Therefore, higher leverage imposes a tradeoff between risk and return that in many firms will tend to make it self-limiting. A similar dynamic is seen with asset substitution, a stratagem in which a firm borrows against low-risk assets but then exchanges them for high-risk assets before the debt comes due.

Correlation-seeking, by contrast, can escape the tradeoff between risk and return. Unlike other types of shareholder opportunism, correlation-seeking does not force shareholders to bear more risk in order to capture higher returns. To the contrary, equity volatility typically *falls* when the correlation between the firm's contingent debt risk and insolvency risk rises. Correlation-seeking reduces the volatility of a firm's equity value because it makes it less likely that the firm's contingent debt will be triggered when the equity has any value. Correlation-seeking therefore is more pernicious than both leverage and asset substitution, because only correlation-seeking typically holds no downside for risk-averse shareholders.

The Scale of the Hazard: Contingent Versus Fixed Debt

Despite the potential scope of the correlation-seeking hazard, neither lawmakers nor commentators have recognized the central role of correlation in the economics of contingent debt. Legal doctrines meant to protect creditors rely instead on principles designed for "fixed" debt—a term used here to mean debt that is certain to come due on a specified future date. Accordingly, a contingent debt is treated as less of an oppor-

3 See Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 Yale L.J. 857, 864 (1996); Elizabeth Warren & Jay Lawrence Westbrook, Contracting Out of Bankruptcy: An Empirical Intervention, 118 HARV. L. REV. 1197, 1226 (2005).

4 See Richard Squire, The Case for Symmetry in Creditors' Rights, 118 YALE L.J. 806, 840–41 (2009) (making the same point with respect to the secured loan).

tunism hazard because it is (by definition) less likely than a fixed debt to come due. On this view, a contingent debt is like a fixed debt, only less so.

There are at least two basic problems with this standard view of contingent debt. The first is that, counterintuitively, a contingent debt contract can capture significantly *more* wealth from a firm's unsecured creditors than would a fixed debt contract with the same face value. This is because a firm that incurs a $100 fixed debt typically receives close to $100 in new assets in exchange. And those new assets mostly neutralize the debt's dilutive effect on the firm's unsecured creditors. But when a firm incurs a $100 debt that has, for example, only a 10% chance of coming due, the firm receives in exchange new assets worth no more than $10. And if this contingent debt is especially likely to be triggered when the firm is insolvent, the disparity between the new assets and the debt's $100 face value greatly reduces expected creditor recoveries.

A second problem with legal doctrines that fail to distinguish between fixed and contingent debt is that the opportunism mechanisms are different for each. What matters most with fixed debt is its total face value relative to the firm's equity value: the higher this ratio, the greater the degree to which losses are borne by the firm's creditors rather than its shareholders. By contrast, a contract that creates a contingent debt with even a relatively large face value, can either benefit or harm a firm's unsecured creditors, depending on whether the correlation between the contingency risk and the firm's insolvency risk is negative or positive. For this reason, legal measures that consider only a debt's face value, and ignore correlations, often produce results that are wholly unrelated to the actual opportunism hazard.

Correlation-Seeking and the Crisis of 2008

Conduct that is consistent with correlation-seeking played a key role in the 2008 financial crisis. Perhaps the most notorious financial crisis bailout was that of the multinational insurer AIG, whose trades in financial derivatives are widely blamed for the company's spectacular unraveling in September 2008. To many observers, AIG's implosion was the fulfillment of Warren Buffet's prophecy that derivative contracts would prove to be "financial weapons of mass destruction." The company merits special attention not only because of the amount of bailout money it received, but also because the Obama Administration has cited AIG as exhibit one in its case for more aggressive federal regulation of derivatives.

The standard account of what happened at AIG—and the account that the administration has adopted—is founded upon a key misperception. According to this view, a small band of derivatives traders, operating at the periphery of AIG's mainline insurance businesses, was able to bring an otherwise sound corporate giant to its knees. But in fact the liabilities on AIG's derivative contracts were not big enough in themselves to break the company. Rather, the conduct that undid AIG was a company-wide affair, in which derivatives traders at an AIG subsidiary sold contingent debts linked to subprime mortgages, and then fund managers at the AIG parent company cranked up the internal correlations on those debts by purchasing risky mortgage-backed securities for the company's general investment portfolio. When the housing market collapsed, it was the combined damage to both sides of AIG's balance sheet that brought the company to the brink of bankruptcy.

Correlation-seeking is consistent not only with the pre-crisis years at AIG, but also with conduct at the government-sponsored mortgage companies Fannie Mae and Freddie Mac. Both Fannie and Freddie incurred deep contingent debts, in the form of guarantees on mortgage assets, that were highly likely to be triggered en masse under conditions when their shareholders would already be wiped out. Conventional accounts attribute risk-taking in these three firms to mere recklessness or to schemes by managers to expropriate wealth from shareholders. But the fact that the companies incurred correlated asset and contingent debt risks suggests that their managers instead were trying to enrich shareholders at the expense of creditors—or, as it turned out, taxpayers. Although the correlated risks ultimately materialized, driving the firms insolvent, it does not follow that the managers' decisions were contrary to shareholder interests at the time they were made. But those decisions did ensure that insolvency, if it came, would be severe, which is why AIG, Fannie Mae, and Freddie Mac were the three firms that received by far the biggest bailouts.

Furthermore, AIG, Fannie, and Freddie illustrate two different forms that correlation-seeking can take. AIG's conduct during the run-up to 2008 is primarily consistent with reverse correlation-seeking, whereby a firm reallocates its investment portfolio into assets that increase the internal correlations on the firm's contingent debts. Fannie and Freddie, by contrast, illustrate the type of correlation-seeking that occurs when a firm has passed the "tipping point" where its contingent debts are large enough in themselves to cause insolvency, and the firm piles on additional correlated debts that pose no downside risk to shareholders. In both cases, the broader point remains that conduct consistent with correlation-seeking helps to explain why the firms suffered such calamitous losses, at taxpayer expense, when their correlated risks materialized.

Reconceptualizing the Law of Contingent Debt

As mentioned above, legal rules for contingent debts take no account of correlations, relying instead on principles designed for fixed debts. This is true not only of the Obama Administration's regulatory proposals in response to the 2008 financial crisis, but also of traditional creditor-protection doctrines such as fraudulent transfer law. In both cases, lawmakers need to shift the emphasis from face values to correlations if legal rules are to neutralize the incentives that create the risk of another AIG, Fannie Mae, or Freddie Mac–style collapse.

In the wake of the 2008 crisis, the Obama Administration has proposed broadly expanding federal regulation of the financial sector. New rules would require financial firms to operate with less leverage, disclose more information about business risk, and pay their executives more in equity and less in cash. In addition, the federal government would acquire direct oversight of the market for financial derivatives. Importantly, none of these proposals hits the correlation-seeking hazard head-on. Some proposals—such as the leverage and disclosure rules—address correlation-seeking only obliquely, and may impose high compliance costs. And others—such as collateral requirements for derivatives and new executive pay rules—may in fact make the correlation-seeking hazard worse.

In light of these drawbacks to the administration's proposed financial sector reforms, a better approach might be for lawmakers to remove legal impediments that now discourage creditors from punishing opportunism directly. The most important of these impediments are the special bankruptcy exemptions for derivative counterparties. Reinstating bankruptcy's automatic stay and its prohibitions on preferences and ipso facto clauses would shrink wealth transfers by relegating derivative counterparties to the status of ordinary unsecured creditors. This change would also make counterparties more vulnerable to correlation-seeking, thereby encouraging them to monitor in order to prevent it. For example, if AIG's sophisticated swap buyers had been more exposed to the risk that AIG would fail, they might have tried to prevent the company from reallocating so much of its investment portfolio into risky mortgage-backed assets.

Besides the bankruptcy exemptions for derivatives, another policy that lawmakers should revisit is the administration's executive pay guidelines. This emphasis on equity compensation implies that the administration is concerned primarily with conflicts of interest between managers and long-term shareholders. But at least at the biggest bailout recipients, the evidence suggests that the more serious problem was conflict between the interests of creditors on the one hand, and the interests of shareholders, as advanced by managers, on the other. And the administration's pay approach, by further aligning manager and shareholder interests, only exacerbates this conflict.

Like current regulatory proposals, traditional creditor-protection doctrines also neglect correlation-seeking. In particular, fraudulent transfer doctrine is currently unsuitable for deterring contingent debt opportunism. Courts analyze fraudulent transfer challenges to contingent debts under the same principles they use for challenges to fixed debts, producing rulings that bear no meaningful relationship to the actual opportunism hazard. Therefore, fraudulent transfer law should be reformed to permit courts to subordinate a contingent debt if a high correlation between the contingency risk and the debtor's insolvency risk was apparent at the time of contracting. Such a rule would nullify the wealth transfer away from the debtor's unsecured creditors, thereby reducing the incentive for shareholders to use such debts to expropriate wealth rather than create wealth.

The Case for Symmetry in Creditors' Rights

118 Yale Law Journal 807 (2009)

The foundation of modern bankruptcy systems is the pro rata rule, which pays all creditors an equal percentage on their claims. But debtors can, and often do, override the pro rata rule through *asset partitioning*, which is the nonconsensual subordination of creditor claims to particular debtor assets.[1] Legal arrangements that partition assets are both varied and ubiquitous, ranging from the corporation and partnership to the secured loan.

Because partitioning arrangements forcefully subordinate creditor claims, they transfer wealth away from claimants such as tort victims who do not adjust when their claims are impaired.[2] Despite the social costs of these wealth transfers, previous scholarship has argued that partitioning arrangements can create value by providing various economic efficiencies.[3] In weighing costs and benefits, however, this literature has taken little account of key differences in the ways that partitioning arrangements prioritize creditor claims.[4]

This Article provides an original framework for comparing the efficiency of different partitioning arrangements. I identify a universal distinction between two basic types of asset partitioning, which I term *symmetry* and *asymmetry*.

Despite their variety, all partitioning arrangements can be categorized as either symmetrical or asymmetrical. Symmetrical arrangements divide creditors into groups and give each group a prior claim to a distinct asset pool in the debtor's estate.[5] An additional feature of symmetrical arrangements is that they give at least some creditors a "deficiency claim," which is a right to levy on the debtor's remaining assets to the extent of any shortfall in the creditor's designated asset pool. Deficiency claims in symmetrical arrangements are

1 Henry Hansmann, Reinier Kraakman & Richard Squire, Law and the Rise of the Firm, 119 HARV. L. REV. 1333, 1343-48 (2006).

2 See Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 YALE L.J. 857, 898-902 (1996).

3 See, e.g., Henry Hansmann & Reinier Kraakman, The Essential Role of Organizational Law, 110 YALE L.J. 387, 398-405, 423-27 (2000).

4 For example, the corporation divides a business owner's creditors into two groups and gives each group the first claim to a distinct asset pool. In contrast, the secured loan gives one creditor a prior claim to one asset pool but confers no similar advantage on the debtor's remaining creditors. Yet previous scholarship contends that both arrangements make it easier for creditors to appraise and monitor debtors, and does not consider whether one structure provides these benefits more than the other.

5 Under current law, the corporation, common law partnership, limited liability company, and Delaware business trust are symmetrical.

always subordinated. In contrast, asymmetrical arrangements give prior claims to some creditors but not others, advantaging select creditors by according them both a prior claim to one asset pool and a pro rata claim to remaining debtor assets.[6]

Symmetry describes creditor priorities in the common law's "jingle-rule" partnership, as well as in limited liability entities such as the corporation, limited liability company (LLC), limited liability partnership (LLP), and Delaware business trust. In each of these commercial arrangements, the firm's creditors have a prior claim to the firm's assets, and the personal creditors of each owner have either a prior (under the jingle rule) or exclusive (under limited liability) claim to that owner's personal assets. Asymmetry, in turn, represents the general partnership as modified by statute in the United States, where partnership creditors enjoy both a prior claim to partnership assets and, to the extent of any deficiency in those assets, a claim to personal assets paid pro rata with the claims of personal creditors.[7] And it represents the secured loan, which gives the secured creditor a prior claim to the secured assets plus a deficiency claim to the unsecured assets that is paid pro rata with the claims of the unsecured creditors.[8]

The distinction between symmetry and asymmetry is powerful because symmetry is superior to asymmetry with respect to each of the major economic benefits of asset partitioning that scholars have identified. The implication is that, when parties opt for asymmetry, they do so for reasons other than wealth creation.

Asymmetry and Purported Efficiencies

The economic efficiency that scholars have most frequently attributed to various partitioning arrangements is the reduction of *appraisal costs*, which are the costs that creditors incur when evaluating a prospective debtor to decide whether to extend credit and on what terms. The first scholar to discuss appraisal costs was Richard Posner, who argued that the doctrine of piercing the corporate veil, which abrogates limited shareholder liability, makes it more expensive for creditors to evaluate lending risk. Although Posner's argument was (in effect) a defense of the corporation's symmetry, scholars subsequently have cited appraisal efficiencies as a benefit of various asymmetrical arrangements, including the secured loan,[9] guaranty contract, and American general partnership.[10]

Yes, asymmetrical arrangements may generate some appraisal benefits relative to the pro rata rule. But the benefits are smaller than they are under symmetry. In particular, asymmetry does not tie lending risk to particular asset pools to the same extent that symmetry does, nor does it enable all creditor groups to specialize by lending against only a portion of a debtor's estate. Therefore, appraisal efficiencies alone cannot explain why parties would choose asymmetry when a symmetrical alternative is available. Nor can they justify a decision by lawmakers to make an arrangement asymmetrical as a default rule.

Another purported benefit of partitioning arrangements is that they make it easier for creditors to monitor debtors and thus to prevent wealth-destroying debtor misconduct. Taken as a whole, scholarly commentary suggests that the difference between symmetry and asymmetry has little impact on creditor monitoring incentives. But in fact only symmetry makes efficient monitoring more likely.

6 Under current law, the secured loan, American general partnership, and guaranty contract are asymmetrical.

7 Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 723(c), 92 Stat. 2606 (codified as amended at 11 U.S.C. § 723(c)).

8 11 U.S.C. §§ 506(a)(1), 726(a)-(b).

9 See, e.g., F.H. Buckley, The Bankruptcy Priority Puzzle, 72 VA. L. REV. 1393, 1424-25 (1986).

10 See Henry Hansmann, Reinier Kraakman & Richard Squire, The New Business Entities in Evolutionary Perspective, 2005 U. ILL. L. REV. 5, 10.

Symmetry has a *focusing effect*, meaning that it increases the degree to which a creditor's recovery is determined by the value of a particular asset pool. This focusing effect promotes the benefits of specialization and also permits creditors to capture more of the benefits of their own monitoring efforts, thereby ameliorating a collective action problem caused by the pro rata rule. Asymmetry, in contrast, provides neither of these benefits. This is because asymmetry has an *insulating effect*, meaning that it shields creditors from devaluation of the assets to which the creditors enjoy prior claims. As a result, asymmetry discourages monitoring by those creditors who could most cheaply prevent a loss. In addition, asymmetry does little to overcome the collective action problem, and makes it harder for creditors to determine whether monitoring will be cost-justified. Asymmetry therefore does not improve monitoring incentives relative to the pro rata rule—and indeed in many situations may make efficient creditor monitoring *less* likely.

A third economic benefit of asset partitioning is quicker distribution of assets to creditors in bankruptcy proceedings. Faster liquidation of debtor assets generates social wealth on the assumption that creditors can earn higher returns on a bankrupt debtor's capital by reinvesting it elsewhere. The three partitioning variations fall along a continuum with respect to bankruptcy speed. Symmetry is more efficient than asymmetry, especially as applied to multiowner entities such as partnerships. And asymmetry in turn is more efficient than the pro rata rule. Symmetry is also the most efficient arrangement if each asset pool is assigned to a different court, such as when a partnership and its partners fall bankrupt and different tribunals handle the estates of the partnership and of each individual partner.[11]

Asymmetry as a Means for Debtor Opportunism

Why would debtors ever choose an asymmetrical arrangement? Symmetry is superior in terms of appraisal costs, creditor monitoring, and bankruptcy speed, and in a competitive market creditors will pass these benefits back to the debtor in the form of lower interest rates. The implication is that business organizers in the United States will always choose a symmetrical entity (such as a limited liability company) over the asymmetrical American general partnership. And debtors who borrow on a secured basis will always negotiate for clauses that subordinate or waive the secured creditors' deficiency claims, rendering the loans symmetrical.[12] Yet American general partnerships and (asymmetrical) secured loans abound, and thus demand explanation.

One explanation is transaction costs. Debtors must contract around default rules of asymmetry, and there will be settings where the costs of doing so exceed symmetry's relative efficiencies.

A second explanation is that a debtor who chooses symmetry does not capture all the social benefits for itself. Some creditors will be unaware of the debtor's partitioning arrangement when they extend credit and hence will not reward the debtor for choosing symmetry. But these creditors may nonetheless benefit if symmetry causes another creditor to monitor.

A third, and likely most important explanation for the widespread use of asymmetry is opportunism, by which I mean the use of asset partitioning to transfer wealth away from creditors who will not adjust to subordination of their claims. The division of debtor assets in a liquidation proceeding is a zero-sum game, and asymmetry tilts the playing field to favor some creditors over others. For this reason, a creditor will charge a lower interest rate if the debtor adopts an asymmetrical arrangement and slots that creditor into the advantaged position. And if this interest rate discount is greater than the relative social benefits of symmetry that

11 Indeed, the opportunity to divide up partnership bankruptcies in this fashion was probably the impetus for the creation of the jingle rule by English courts after Parliament introduced a formal bankruptcy system in the sixteenth century.

12 Secured creditors in fact often do agree to waive their deficiency claims, making their loans nonrecourse.

the debtor captures (minus symmetry's higher transaction costs, if any), the debtor will choose the asymmetrical arrangement even though symmetry would be more efficient.

Because it transfers wealth, asymmetry also destroys wealth. The expected wealth transfer produced by asymmetry will lead to overinvestment by artificially depressing the interest rate demanded by the advantaged creditor. In addition, creditors who are "adjusting" will incur screening and monitoring costs to protect themselves from subordination risk. Importantly, adjusting creditors will incur these costs regardless of whether the debtor in fact adopts an asymmetrical arrangement, which means that the availability of asymmetry imposes social costs even when all creditors are adjusting and hence no wealth transfer occurs. Moreover, adjusting creditors will demand higher interest rates to reflect their anticipated monitoring costs, which will produce a deadweight loss by making it unprofitable on the margin for debtors to secure funding for wealth-creating projects. These direct costs of opportunism mean that, even in settings where appraisal, monitoring, and bankruptcy-speed efficiencies are unimportant, the debtor's mere option to adopt asymmetry will destroy social wealth. Thus lawmakers should consider reforming asymmetrical arrangements to be symmetrical as a way of creating social wealth.

Symmetry applied: reforming the secured loan

The secured loan is, next to the business corporation, the most important partitioning arrangement in the modern economy, with approximately 70% of the assets of bankrupt commercial debtors pledged to secured creditors.[13] It gives the secured creditor certain privileges—namely, protection against debt dilution, and a right to retrieve debtor assets conveyed to third parties—that are not provided by other asymmetrical arrangements, and that make the case for symmetry even more compelling.

The Secured Loan and Purported Efficiencies

Several scholars have argued that the secured loan reduces appraisal costs. For example, Richard Posner has suggested that the secured loan permits unsecured creditors to economize on their appraisal efforts because "the pool of unsecured creditors is smaller and the pool of assets available to satisfy the unsecured creditors is also smaller."[14] Cast in this way, Posner's argument implies that unsecured creditors can disregard both the amount owed the secured creditor and the value of the secured assets. But this is untrue: because of the secured creditor's deficiency claim, a drop in the value of the secured assets often will harm the unsecured creditors even more than it harms the secured creditor.

The secured loan now provides somewhat greater appraisal economies to the secured creditor, whose prior claim to the secured assets reduces his exposure to the risk that the unsecured assets will depreciate. This benefit is heightened by the secured creditor's property right in the secured assets, which makes it more likely that those assets will be available if the debtor defaults. These considerations suggest that a debtor can reduce overall appraisal costs by giving a creditor a secured claim to those assets the creditor can appraise more cheaply than other creditors can. But the secured loan's asymmetry then works against this potential source of efficiency, because it makes the value of the unsecured assets an important component of the secured creditor's overall risk exposure.

Symmetry would enable both secured and unsecured creditors to incur lower appraisal costs than they do now. If the secured creditor's deficiency claim were subordinated, the value of the unsecured assets would

13 The percentage of secured assets is probably somewhat lower for debtors outside bankruptcy, as debtors are more likely to issue secured debt when on the brink of insolvency.

14 RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 428 (7th ed. 2007).

affect the secured creditor's recovery only if the unsecured assets were above water even though the debtor was insolvent. Moreover, even if the secured creditor did recover from the unsecured assets, his share would be smaller under symmetry than under asymmetry. Symmetry therefore would further reduce the need for a secured creditor to valuate the unsecured assets when appraising a debtor's estate. And unsecured creditors similarly could be less concerned with the value of the secured assets, because under symmetry the secured creditor's deficiency claim could not affect their recoveries.

While several scholars have argued that the secured loan promotes creditor monitoring efficiencies, they have disagreed about *which* creditors it encourages to monitor. Thomas Jackson and Anthony Kronman began the debate by observing that a secured loan shifts risk onto the unsecured creditors, and then concluding from this observation that debtors issue security in order to increase the unsecured creditors' incentive to monitor. Saul Levmore theorized that a secured loan instead encourages the *secured* creditor to monitor. Levmore argued that creditors will naturally try to free-ride on the monitoring efforts of others, but that a creditor will not mind monitoring on behalf of all creditors as long as he receives the priority right as compensation.

In the language of this Article, the Jackson-Kronman theory emphasizes the insulating effect of the secured creditor's deficiency claim, and the Levmore theory emphasizes the focusing effect of the priority right. And, because it is asymmetrical, the secured loan has both effects. The problem is that the two effects work at cross-purposes, with each undercutting the monitoring incentives the other might create. The secured loan's asymmetry squanders the opportunity for optimal monitoring incentives, because it insulates the secured creditor from a drop in the secured assets' value. On the other hand, the secured loan's asymmetry only moderately increases the degree to which the unsecured creditors capture the benefits of monitoring the unsecured assets. And it likely discourages them from monitoring the secured assets, because their payoff from doing so is highly sensitive to the secured assets' value, and it is the secured creditor who typically will be able to assess that value most cheaply.

The secured loan would encourage efficient monitoring by secured and unsecured creditors alike if it were reformed to be symmetrical. If the secured creditor's deficiency claim were subordinated, the insulating effect would recede, leaving the focusing effect to predominate. This would give the secured creditor greater incentive to protect the secured assets. Symmetry would also encourage efficient monitoring by the unsecured creditors, because it would reduce the overlap between the secured creditor's claim and their own claims, thereby permitting them to keep more of the benefits of monitoring the unsecured assets for themselves.[15]

Finally, the secured loan's asymmetry slows down liquidation proceedings by preventing a court from distributing unsecured assets without first determining the amount of each secured creditor's deficiency claim, which requires verification of secured creditor proofs of claim and valuation of the secured assets.[16] Symmetry would remove this impediment to distribution of the unsecured assets. Symmetry would also reduce the incentive for unsecured creditors to contest secured claims, and indeed would eliminate it in situations where the secured assets had dropped further underwater than the unsecured assets had. In this way, symmetry would not only expedite distribution of secured assets, but also save on legal fees and free up judicial resources.

15 This observation necessarily applies only to voluntary unsecured creditors. No partitioning arrangement can encourage monitoring by involuntary creditors such as certain tort claimants.

16 11 U.S.C. § 506(a)(1) (2000).

The Secured Loan's Asymmetry as a Source of Opportunism

Like other asymmetrical arrangements, the secured loan invites debtor opportunism by ensuring that one creditor will recover a higher percentage on his claim than others will if the debtor falls bankrupt. Subordination of the secured creditor's deficiency claim would increase recoveries for nonadjusting creditors, thereby reducing the amount of the expected wealth transfer. And smaller wealth transfers, in turn, would mean a reduction in the interest-rate distortions that cause overinvestment[17] and less need for creditors to incur costs to protect themselves.

Symmetry Versus previous Reform Proposals

Although symmetry is only the latest in a long line of reform proposals for the secured loan, it differs from its predecessors in one key respect: all previous proposals would scale back the secured creditor's priority right. For this reason, previous proposals demand a tradeoff: they would increase recoveries for nonadjusting creditors, but at the expense of social benefits that secured loans now provide in terms of appraisal economies and bankruptcy speed. And by leaving untouched the secured creditor's deficiency claim, these proposals would do nothing to correct how the secured loan now discourages efficient monitoring.

Symmetry avoids the tradeoff inherent in each of these proposals. Like other proposals, symmetry would reduce opportunism costs by increasing recoveries for nonadjusting creditors. But symmetry would accomplish this result while preserving the priority right, thereby enhancing rather than undermining secured lending's current economic benefits in terms of appraisal efficiencies and bankruptcy speed. And only symmetry corrects how the law of secured lending now discourages efficient monitoring. In other words, symmetry is the only proposal with no evident economic downside. In addition, the fact that symmetry leaves intact the secured creditor's priority right makes it more attractive politically, as the priority right is at the core of the traditional conception of secured lending.

Similar economic benefits likely would result from parallel reform of the American general partnership, which also is asymmetrical under current law. In particular, subordination of the claims of partnership creditors to partners' personal assets would discourage parties from using the partnership to transfer wealth away from the partners' personal creditors, and would pay social dividends through lower debt appraisal costs, better creditor monitoring, and faster liquidation proceedings.

17 For an analysis consistent with this one, see George G. Triantis, Financial Slack Policy and the Law of Secured Transactions, 29 J. LEGAL STUD. 35, 50 (2000).

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