Innovation Economy
Public Policy Outlook 2014

The Environment

Public policy's impact on the innovation economy continues to grow, for three reasons.

- *One,* government is having a more pervasive influence on the entire economy.
- *Two,* as the tech sector matures and becomes increasingly pervasive, it is playing a bigger role in the economy and people's lives. That gives policymakers the ability and incentive to intervene.
- *Three*, startups are disrupting regulated sectors like education, financial services, health care services, and transportation. When you disrupt the *status quo*, the *status quo* fights back.

The Mood in DC

Congress will probably have a relatively quiet year, in terms of actual legislation. It's an election year for Members, so whatever happens needs to get done by the spring or mid-summer. This may be a good thing, giving everybody more time to digest two massive recent pieces of legislation, the Affordable Care Act (which rem designed health care) and Doddm Frank (which rem designed financial services). Look to the ***federal Agencies*** (folks like the SEC, FTC, FinCen, FDA, HHS, etc.) and the ***states*** (especially those that tend to be out front, like CA and NY) for most of the action this year.

The Issues

Access to talent remains one of the biggest challenges for growing companies. ***Immigration reform*** could ease the pain by creating a new visa category for entrepreneurs and investors, increasing the number of H-1B visas for high-skilled workers, and adding more employment-based green cards. Last year, things looked promising. This year, the prospects look a lot dimmer. We think immigration reform will stay on the agenda and in the news, and there's a decent-to-good chance the House will pass a bill or series of bills. (The Senate passed a comprehensive bill in 2013.) That said, it will be a steep uphill climb for the House to pass something comprehensive enough for the Senate and the President to accept. As a result, as much as we hope we're wrong, we aren't optimistic we'll see reform in 2014.

Patent reform is one of the few major pieces of legislation that may get passed in 2014. Congress and the President want to do something bi-partisan that's good for the economy (especially small businesses), and patent reform is an obvious candidate. Two years ago, Congress passed the *America Invents Act*, which made a number of structural changes to our patent system. Now, the focus is on how to curb abusive litigation practices through changes such as shifting fees onto the losing party, altering how discovery works, and increasing transparency so people understand who's suing them and why. The House passed a bill in late 2013, and in his State of the Union address the President called on the Senate to act. The hope is that the Senate will be able to get a bill to the floor in the spring/summer of 2014 and the House and Senate will pass a final law this year. Although the current legislation isn't focused on abusive patent litigation in the International Trade Commission, we expect Congress will give that issue attention in 2014 in the form of oversight and, possibly, legislation.

We're still in the relatively early stages of some big shifts in ***capital formation***. Two years ago, Congress passed the JOBS Act. It included four basic shifts to make it easier for growing companies (and, in some cases, venture funds and others) to raise capital:

- The ***IPO on-ramp*** makes it somewhat less burdensome and expensive for smaller companies to go public;
- New rules for ***private offerings*** let companies and venture funds selling securities to "accredited investors" talk about their offerings much more openly, including in blogs, presentations, and the media;
- New "***Reg A+***" rules will let companies sell up to $50M annually in securities to the general public using a more streamlined regulatory process (sometimes referred to as a "mini-IPO"); and
- New ***crowd funding*** rules will let companies do crowd funded equity offerings. (You can do crowd funding today, but you can't do it to sell equity.)

Rules for the first two are final; rules for the second two are only proposed. Even when they're final, it will take a while to see how investors and entrepreneurs react. Each of the options has different tradeoffs in terms of things like liquidity, shareholder base, offering size, and regulatory burden. Together, they will give those raising capital a new menu of possibilities to choose from. The policy changes are taking place within a broader shift in how capital is being raised and deployed, as companies like AngelList and NASDAQ's Private Market use technology to connect investors to companies and as venture capital continues to be augmented by a broader array of "innovation capital" coming from angel investors, corporate venture groups, private equity firms, and others.

In ***fin tech,*** Bitcoin is the hot topic of the day. People are moving beyond the initial fear and chaos to a deeper understanding of the real issues, and they're starting to see that the really important issue isn't Bitcoin as a novelty item or trading vehicle, but ***digital currencies*** as the foundation for an open, global, digital payment rail. The public policy issues aren't easy and they'll take a while to figure out, but we expect we'll see more clarity on several fronts during 2014. In the broader financial services/payments world, we think we're in the early stages of a profound shift, driven by entrepreneurs with innovative business models and technologies looking to extend – and in some cases fundamentally change – the *status quo*. Given the highly regulated nature of this sector, their success is closely tied to how policymakers react to innovation. In particular, the long-term impact of the ***Durbin Amendment*** on ***interchange rates*** is a big deal. We think this will take several years to play out, partly because the court case overturning the Fed's rules has to work its way through the system and partly because Durbin (and new entrants) are touching off broader, market-driven shifts in the interchange system. In the near term, the ***Target security breach*** adds an interesting twist, putting merchants on their back heels and renewing the battle between merchants, banks, and payment networks over who bears what risks – and reaps what rewards – from payments. In the somewhat longer term, if digital currencies take hold as a new payment rail, the entire conversation over interchange will change in a fundamental and irreversible way. Probably the biggest headache for entrepreneurs in financial services remains the complex array of state and federal regulations and regulators, including the ***money transmitter regime***. Meaningful positive change at a systemic level is very hard to envision, at least in the near term. But watch California and NY, both of which are actively looking at their money transmitter laws and how they work, both generally and specifically for Bitcoin companies.

Data privacy and ***data breach*** issues remain a big deal in Washington, D.C. and in the states. It's hard to say with any certainty what will happen, where, and when, because privacy is complicated, rapidly changing, deeply emotional, and involves so many different kinds of information, businesses, and uses. The risk of a major shift in U.S. privacy policy is highest after a high-visibility trigger (think Target and Snowden…), when the desire to protect consumers can run head first into issues that are core to the innovation economy. So while we can't predict with any certainty what's in store, here are a few things we're watching. One, California. Privacy and data security are top of mind in Sacramento and important players in the Democrat-dominated legislature have some very strong views about the kinds of protections individuals deserve. We expect to see legislation introduced soon that would restrict data collection and retention, both for financial transactions and more broadly. Two, the Federal Trade Commission. The FTC is a consistent force that uses its enforcement powers and consent decrees to get companies to provide greater protections and better disclosures to consumers. In addition to its ongoing activities, the FTC recently started delving into the privacy/security issues raised by the Internet of Things. And three, Silicon Valley. Tech companies are in the midst of a debate with the federal government over the role they will play in the government's data gathering efforts, which will have important implications for all private sector actors who control data of interest to federal law enforcement and security agencies.

Speaking of Snowden, his disclosures are having a big influence in two other important areas: ***Internet governance*** and ***international trade***. In both cases, countries that want to create national silos within the Internet or to restrict trade have new ammunition. Rightly or wrongly, the NSA spying revelations are being used to justify ***data localization*** requirements (which say data from a country has to be stored in that country), ***trade barriers*** (such as equipment procurement rules that favor domestic manufacturers), and proposed changes to Internet governance that could undermine the Internet's free and open nature. These trends have very important potential implications for ***cloud computing companies***, ***hardware manufacturers***, ***Internet companies***, and anybody who cares about (or relies on the continued existence of) a free and open Internet.

Nearer to home, Washington is working to get its head around ***peer-to-peer businesses*** (like AirBnB, Uber, and peer-to-peer lending platforms). Policymakers are intrigued, because these platforms seem to be good for consumers. But they're also concerned, because peer-to-peer solutions usually don't fit with (and sometimes take on) existing regulatory systems and assumptions about how things work. Absent any big blowups hurting consumers in the peer-to-peer world, we see 2014 primarily as a year of exploration (at least at the federal level), as legislators and regulators try to develop a point of view on what role they should play and what concerns they should and shouldn't worry about.

For ***healthcare companies,*** Obamacare implementation and its effects on the U.S. health care sector remain front and center. During 2014, the individual mandate kicks in and insurers will no longer be allowed to discriminate based on preexisting conditions, impose annual limits on coverage, or renew plans that are not Obamacare compliant. While we don't see Congress changing the Obamacare law, it is possible they will try to deal with ***health IT*** policy issues (such as Electronic Health Record (EHR) interoperability and telehealth). More broadly, we expect to see some movement in the Administration (and maybe in Congress) on developing a risk-based regulatory framework for health IT and fleshing out the regulatory framework for ***mobile medical aps***. We remain cautiously optimistic that the ***2.3% tax on medical devices***, which is having a negative effect on device startups and investors, may be able to get fixed this year.

The risk of ***cyber attacks*** remains high. It's possible, but not probable, that Congress will pass legislation in 2014 giving the Administration new powers to combat the risk. In the meantime, the

Administration continues to move forward with its Executive Order and to encourage companies to adopt its ***cybersecurity framework***. As in the privacy area, a major incident could shift things quickly.

U.S. corporate ***tax policy*** remains an issue for larger companies. It may also be affecting smaller companies indirectly, by creating an incentive for larger companies to hold cash (and make acquisitions) overseas. But there's no prospect of meaningful reform in sight. In fact, lawmakers' desire to tackle tax reform comprehensively will probably have a negative near-term effect by leaving discrete issues (like the ***R&D tax credit***) in a kind of limbo, where they continue to be dealt with in a short-term, piecemeal way.

Longer term, ***radio spectrum*** remains a big issue as the FCC works to figure out how to use incentive auctions to allocate spectrum formerly used by broadcast TV stations. And the House of Representatives is kicking off major, multi-year reviews in two very important areas for the innovation economy: ***copyright*** and ***telecom regulation.*** The basic federal statute governing the telecom sector hasn't been revised since 1996. Since then, there have been huge changes as the landscape has become fundamentally mobile and Internet-based.

What It All Means

In the end, innovative companies are rightly focused on building their businesses, not on what happens in Washington, D.C. or state capitals. But public policies – from spectrum to privacy to regulation and beyond – can have a profound effect on how growing companies interact with their customers and get the people, capital, data, and other inputs they need to grow. That's we think even those who wish Washington didn't matter will be smarter and faster if they understand whether – and if so how – policymakers can affect their future.