PIAUSA.org
Professional Inventors Alliance USA

U.S. House of Representatives
Washington, DC 20515

June 20, 2011

Dear Representative:

Our organizations represent America's new jobs creators – the *small businesses*, *start-up entrepreneurs*, *independent inventors*, and *technical professionals* employed by companies of all sizes. We write in strong support of the Amendment to H.R. 1249 introduced by Congressmen John Conyers, James Sensenbrenner and Don Manzullo[1] that will stop the diversion of patent fee revenue to the general Treasury.

We have long voiced our view that patent reforms must focus on properly funding the U.S. Patent and Trademark Office (PTO) and not on other controversial and harmful provisions that would create legal uncertainties for years to come. Permitting the PTO to retain its fees subject to Congressional oversight will allow the agency to hire more examiners, reform its internal procedures, and modernize its information technology infrastructure to reduce the massive backlog of pending patent applications and improve the quality of examination. That is the real patent reform that America needs.

Moreover, we support the Conyers/Sensenbrenner/Manzullo Amendment because it permits Congress to retain its control and oversight over fees charged by the PTO, ensuring enhanced accountability and transparency. The Amendment does so by removing Section 10, which would otherwise grant the PTO broad authority to set fees based on no guidance or policy constraints except the PTO's opaque and unknown interpretations of "aggregate costs". Such authority would exceed the PTO's institutional mandate and competence.

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[1] Amendment #20 by John Conyers, James Sensenbrenner and Don Manzullo, June 13, 2011. Available at http://www.rules.house.gov/amendments/CONYER_049_xml613111824182418.pdf . (Would strike the entire bill except Section 2, Section 22 and Section 31).

The PTO is not a neutral, disinterested party in fee-setting; it has a prima facie conflict of interest because of its direct administrative stake in the outcome. PTO's prior record raises concerns that Section 10 would allow the PTO to meet "the aggregate estimated costs to the Office" constraint while *skewing* fees among various components to serve its administrative convenience of suppressing incoming workload. Fee apportionment necessarily affects important public policy questions and must be reserved by Congress.

We also urge you to oppose the Managers' Amendment[2] that would establish a 15% surcharge on all current PTO fees and give the PTO the authority to raise the examination fee from $220 to $5,020 in a new prioritized examination track. This would divert scarce resources away from the standard examination track and provide yet another bailout for large corporations that can afford to pay a king's ransom to escape PTO "backlog purgatory." Rather, Congress should address the PTO backlog problem more broadly by returning to PTO at least a portion of the $0.7 billion of fees *already paid* on applications in the backlog *awaiting examination*. This would be a much fairer solution, permitting the PTO to address pendency for *all* applicants – not only for a few with deeper pockets.

Neither of these proposed changes is supported by an objective financial analysis showing that it is justified based on actual PTO costs. The 15% fixed increase to all applicants and existing patentees is clearly arbitrary, while the 22-fold higher fee for prioritized examination is transparently discriminatory against small firms and independent inventors. We would support reasonable fee increases but Congress should insist that all fee increases be based on objective financial analysis and projections persuasively demonstrating that they are justified by PTO's actual costs.

Finally, we turn your attention to a major legal flaw in H.R. 1249 which indicates lack of adequate forethought in drafting and amending this bill. Owing to substantial spread in examination timing across examiner workgroups at PTO, a later-filed application can be issued well before an earlier-filed prior-art application reaches an examiner's desk for examination. With no effective legal recourse available to the first-filer of the pending application for removing the later-filed issued patent, the second-filer would end up with a valid patent, solely due to PTO administrative delay variations. This result is in direct contradiction to H.R. 1249's stated purpose of awarding patents to the first-inventor-to-file.

These concerns are explained in further detail in the additional text attached to this letter. We thank you for your attention and urge you to vote in support of the Conyers/Sensenbrenner/Manzullo Amendment and oppose the Managers' Amendment in its current form.

Sincerely,

IEEE-USA
IP Advocate
National Association of Patent Practitioners
National Congress of Inventor Organizations
National Small Business Association
Professional Inventors Alliance USA

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[2] Amendment #15 by Lamar Smith, June 13, 2011. Available at http://www.rules.house.gov/amendments/MgrAmdt613111816461646.pdf

ABOUT OUR ORGANIZATIONS

IEEE-USA Institute of Electrical and Electronic Engineers

IEEE (the Institute for Electrical and Electronic Engineers) is the world's largest professional association of technology professionals. With 210,000 members, IEEE-USA's mission is to recommend policies and implement programs specifically intended to serve and benefit the members, the profession, and the public in the United States in appropriate professional areas of economic, ethical, legislative, social and technology policy concern.

http://www.ieeeusa.org/policy/policy/2011/021511a.pdf

IP Advocate

IP Advocate is a non-profit organization representing the academic research community. We educate our members in the complex flow of policy, law and procedure, and provide practical entrepreneurial advice for technology transfer and commercialization of intellectual property.

www.ipadvocate.org

http://www.ipadvocate.org/mibj/index.cfm

National Association of Patent Practitioners

The ***National Association of Patent Practitioners*** (NAPP) is a professional organization of patent practitioners, that is people who assist inventors and small businesses (and sometimes larger corporations) to obtain patents. NAPP members overwhelmingly believe in maintaining a strong US patent system that can produce strong patents to benefit emerging businesses. www.napp.org.

https://www.napp.org/resources/NAPP-PartialOppTo2009SenateBill.pdf

National Congress of Inventor Organizations

The ***National Congress of Inventor Organizations*** (NCIO) is an educational organization that provides independent inventors and entrepreneurs with resources, guidance, articles, and how-to information along the path to commercialization. NCIO also offers support through its web site and newsletter to entrepreneur and independent inventor groups. NCIO web sites attract 150,000+ unique visitors annually with an email broadcast outreach estimated at 10,000 per broadcast.

http://www.nationalcongressofinventororganizations.org

National Small Business Association

The ***National Small Business Association*** (NSBA) is a national nonprofit membership organization. Established in 1937 and reaching 150,000 small businesses across the nation, NSBA is proud to be the country's oldest, nonpartisan small-business advocacy organization. www.nsba.biz

http://www.nsba.biz/docs/patent_reform.pdf

Professional Inventors Alliance USA

The ***Professional Inventors Alliance USA*** (PIAUSA) is a national organization promoting inventor-entrepreneur and small business interests since 1993. PIAUSA works to protect American invention and encourage innovation by providing the nation's independent inventors a united voice to improve public policy. www.piausa.org, http://truereform.piausa.org

DETAILED REASONS FOR OUR POSITIONS

Prioritized Examination

We oppose the establishment of a prioritized examination program that selects patent applications out-of-turn for examination as provided in the Managers' Amendment.[3] This program would create a new virtual examination division within the PTO – a "club" – for large corporate patentees who can afford the $5,000 prioritized examination fee. Many small entities, startups and individual inventors would be excluded from the "club" due to the prohibitive examination price. The examination *process* for "club" members would be the same as that in the standard examination track, with essentially comparable time per case spent by examiners. However, the "club" would have a zero backlog, thereby producing patent grant pendency of less than 12 months for the "club" members.[4] This program is essentially a bailout for those who can afford the extortionary fees to get out of PTO backlog "purgatory" while leaving the rest in it.

With substantially larger PTO revenue per application raised from "club" applicants who purchase PTO's promise of short pendency, the PTO would have strong incentives to allocate full examination resources to the "club" at the expense of applicants in the standard examination track. Under the Managers' Amendment, however, the PTO is not precluded from shifting resources to the priority examination "club" at the expense of all other applicants. There are absolutely no statutory safeguards to prevent it.

PTO's pronouncement elsewhere that it would use only new examination resources (paid for by prioritized examination fee revenues) for examining out-of-turn prioritized applications[5] is neither legally binding on the PTO nor credible. PTO's counterfactual assertion that no resources would be taken away from the standard examination track belies operational imperatives. It takes 8 months for a new recruit to graduate from the PTO Patent Training Academy,[6] subsequent to which they can begin to assist in examining applications under close supervision and further practical training. Who will examine the prioritized applications while the new recruits are being trained? Who will train them? What part of the examiner corps would the *additional* experienced examiners-trainers come from? It takes about 6 years to train an examiner "to do the job to the point that they can sign off on a patent without going through their supervisor."[7] During this time, who will review, correct and sign off on new patents issued in the prioritized examination track?

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[3] This program had been promulgated in a new rule published in the Federal Register: *Changes To Implement the Prioritized Examination Track (Track I) of the Enhanced Examination Timing Control Procedures*, Final Rule. 76 Fed. Reg. 18399, (April 4, 2011). At http://edocket.access.gpo.gov/2011/pdf/2011-7807.pdf. Five days before the final rule was to take effect, the PTO suspended its implementation indefinitely citing "funding limitations." 76 Fed. Reg. 23876, (April 29, 2011). At http://edocket.access.gpo.gov/2011/pdf/2011-10376.pdf.

[4] 76 Fed. Reg.18401, Col. 1.

[5] 76 Fed. Reg.18403

[6] *See* USPTO, *House Judiciary Committee Chairman John Conyers Addresses USPTO Patent Training Academy Graduation Ceremony*, (January, 2008) at http://www.uspto.gov/news/pr/2008/08-01.jsp (Through the Patent Training Academy, new patent examiners go through an eight-month university-style training which is designed to provide the participants with a strong foundation and more advanced skills when they enter the examination corps upon graduation

[7] Remarks of USPTO Director James E. Rogan at the ABA/Intellectual Property Law Section Conference, Philadelphia, PA (June 27, 2002). At http://www.uspto.gov/news/speeches/2002/speech2002jun27.jsp.

There appears to be no way to build another PTO examination corps for the prioritized examination track without taking away examination resources that would otherwise serve the standard examination queue.[8] Moreover, these investments would not later benefit the standard examination track.

The PTO is characterizing the buildup of the new prioritized examination corps as merely a *budgetary* matter for this fiscal year that hinders the Office's ability to *hire* new examiners.[9] Its assertion that "any effect should not extend into future fiscal years" is simply not credible. The hindrance would be far beyond the cost of hiring new examiners – it is about the diversion of resources from the standard examination track for many years. We object to any program that delays by even one day the issuance of patents in the standard examination track.

Any argument that these resources could be marshaled without affecting the standard examination track through increased use of overtime and bonus pay to *existing* examiners (requiring more money), clearly means that the PTO could (and therefore should) increase its current examination force in that way – but apply it to perform more of the work that it *already has accumulated.* Recall that applicants of the 720,000 applications awaiting first action have *already* paid an average fee of about $1,000 per application. This unearned PTO revenue amounts to $0.7 billion that the PTO *already received* to do the work it has not even began doing; the money is gone and the PTO is now merely seeking more.

The PTO now says it can augment its examination corps using money alone. If new examination resources are to be acquired for the PTO in this way, why use them only for the benefit of a few applicants, and not for all those who have been in line for years after having paid $0.7 billion for the PTO to acquire these examination resources? The PTO now says that it finally intends to acquire the required examination resources and that these applicants must re-file their applications and pay again in order to benefit from the new resources.[10] This is unconscionable. Congress should simply return to the PTO at least a portion of the $0.7 billion instead of double-dipping in applicants' pockets. Creating Track I merely obfuscates the real problem and effectively condones the prior diversion of fees away from PTO.

No one has considered the public patent policy fundamentals and the profound economic effects of this prioritized examination program. The preferential treatment of certain applicants over others would create an earlier patent protection shield for patentees that can afford to be in the "club" while leaving unprotected those who cannot. This would perturb market balances and would disproportionately reduce market risks to larger entities that can afford to obtain their patent protection early. The adverse effects on small businesses and startups due to these imbalances can be substantial. This provision, like most other provisions of this bill, favors those who have greater resources at the expense of those who do not.

We are concerned that the PTO is seeking to adopt this prioritized examination program to ease the pressure it receives from would-be "club" members who can afford to lobby for their preferred way of tackling the long pendency problem. Once this program is in operation, the PTO would face little

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[8] *Id.* ("If you give us 950 examiners in one year, the pendency will go up, not down. … Every time we hire a crop of new examiners, we have to pull experienced examiners off the line in order to train them.").

[9] 76 Fed. Reg. 18403, Col 2. ("the Office appreciates that implementation of the Track I program could have an effect on the examination of non-prioritized applications during fiscal year 2011 due to the current budget situation and its impact on the Office's ability to hire new examiners, but any effect should not extend into future fiscal years.").

[10] 76 Fed. Reg. 18401, Col. 2 (suggesting continuations can be filed); 18404, Col. 2 (suggesting even abandonment of the earlier pending application).

pressure to solve the pendency problem for the *standard* examination track. Rather, the PTO will always be able to point to the "options available to applicants" ($5000) for accelerating their application. In fact, we believe that the adoption of the prioritized examination program is a sure recipe for perpetuating PTO's backlog problems indefinitely.

Finally, the proposed prioritized examination and grant program in the Managers' Amendment highlights a major legal flaw of H.R. 1249, which exist independently of this program solely due to PTO administrative delay variations. H.R. 1249 would create a slew of *false patent grants* with no effective means to cancel them. Because the prioritized examination program turns on its head the order of examination among applications, it creates many more opportunities for a later-filed application in the prioritized examination "club" to be issued within a year after filing, well before an earlier-filed prior-art application reaches examination in the standard examination queue. Examiners may not even know of the existence of the pertinent prior art in the early-filed application awaiting office actions. Thus, a patent may issue to the accelerated examination "club" member on the same subject matter of the first-filer's pending application, with no effective recourse available to the first-filer for removing the later-filed issued patent.

This result is particularly fatal when the first-filed application is unpublished because Section 102 under H.R. 1249 provides no legal basis to invalidate the second-filed issued patent. Ironically, the second-filer would be able to sue the first-filer for patent infringement and prevail – a result in direct contradiction to H.R. 1249's stated purpose of awarding patents to the first-inventor-to-file. In contrast, under current law, the first-filer can copy the claims of the second-filed issued patent and provoke an interference proceeding at the Office and thereby cancel the patent. No such procedure is available under H.R 1249; this is not a derivation case. After several years, the first-filer would be granted a patent, which would constitute new prior art to invalidate the second-filer's false patent. This possibility of having thousands of such cases per year, in which false patents are enforced and licensed only to be cancelled a few years later by newly published prior art, would generate great confusion, uncertainty and costs. This flaw is entirely due to H.R. 1249's provisions and does not occur under current law.

This defect in H.R. 1249 exists even without the prioritized examination program (although at lower occurrence frequency) because of substantial dispersion in pendency across examiner workgroups. This example demonstrates the lack of adequate forethought that went into drafting and amending this bill.

Fee Setting Authority – Policy Implications

Congress once passed a law in 1980 that gave the PTO authority to set fees. However, before the law went into effect, Congress corrected its mistake and repealed that authority.[11] We urge that Congress not repeat a previous mistake that would require a correction yet again. We oppose granting broad authority to PTO to set virtually all aspects of its user fees without adequate safeguards that prescribe *by statute* the detailed policy principles that govern the determination of such fees. Our concerns are not merely about

[11] The current PTO fee structure has its roots some 30 years ago. In 1980, Congress changed the patent fee structure which had been in effect since 1965 by enacting H.R. 6933 into law – the Patent and Trademark Laws, amendments, P.L. 96-517. This law raised patent user fees across the board, established new patent maintenance fees, and granted fee-setting authority to the PTO, to be exercised no more frequently than every three years. Prior to its taking effect, this law was amended by P.L. 97-247, the Patent and Trademark Office, appropriation authorization on Aug. 27, 1982. The latter repealed the impending PTO fee-setting authority but doubled the patent application and maintenance fees from the levels authorized by P.L. 96-517. The increased fees went into effect on October 1, 1982.

procedures. Section 10 of H.R. 1249 contains no detailed policy principles to which the Office must adhere in exercising its delegated authority to set fees. The only requirement in the proposed statute is that PTO set fees to "recover the aggregate estimated costs to the Office."

While the PTO has expertise pertaining to its costs, it has neither the economic competence, nor mandate, nor institutional expertise to promulgate the economically efficient policies that determine *apportionment* of its fees across *specific* components (see Slides 4-7, 12, 13 of Attachment A). Moreover, the PTO is not a neutral disinterested party for making such determinations because it has prima facie conflict with its direct administrative stake in the outcome (see Slides 8-11 of Attachment A). Under Section 10 of the bill, the PTO would be permitted to apportion fees and *skew* them among various components in a manner that serves its administrative convenience of suppressing incoming workload while meeting "the aggregate estimated costs to the Office" constraint. The following example in the next few paragraphs is instructive.

Recovery of patent costs for the Office is accomplished by patent fees that broadly comprise two major components: the "front end" fees that applicants must pay before the patent grant and the "back-end" fees paid after the patent grant every four years so long as the patentee wishes to maintain the patent in force (maintenance fees).

By requiring that only a fraction of the Office's costs be paid at the "front end," leaving the rest to be recovered at the "back-end," the current statute effectively subsidizes application costs for all applicants using the maintenance fees from only those having successful and maintained patents. In so doing, current law balances various economic and patent policy interests:

(a) applicants are able to defer patenting costs until they achieve commercial success – a provision that eases financial burdens on startups;
(b) it encourages filing more patent applications, engendering more disclosure of inventions to the public– even from ultimately unsuccessful applicants;
(c) requiring relatively high "back-end" maintenance fees provides patentees stronger incentives for letting their unused patents lapse earlier – thereby increasing other innovators' freedom to operate in the field.

All three of these essential aspects of *apportionment* of patent fees are clearly outside of PTO's institutional role, expertise or economic competency and are best left for Congress. Indeed, prior to enacting the patent fee structure in the Patent and Trademark Laws, Amendments of 1980,[12] Congress received testimony and deliberated on the value and benefits of all three rationales listed above for ensuring that a substantial part of PTO fee revenues comes from the "back-end" fees. These deliberations recognized the importance of easing financial burdens on startups,[13] which the President reiterated in his signing statement;[14] the importance of encouraging disclosure through subsidizing low cost applications;[15]

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[12] PL 96-517, 94 Stat 3015 (December 12, 1980).

[13] H. Rep. 96-1307(I), 4-5 (1980) ("in order further to soften the impact on small business and individual inventors, the fees are to be paid in four installments over the life of the patent. This system … has the advantage of deferring payment until the invention begins to return revenue to the inventor. Should the invention prove to have no commercial value, the inventor has the option of permitting the patent to lapse, thus avoiding all further fees.")

[14] President Jimmy Carter, *Patent and Trademark System Reform Statement on Signing H.R. 6933 Into Law*. (December 12, 1980). Available at http://www.presidency.ucsb.edu/ws/index.php?pid=44398. ("A new system of fees for maintaining patents in force will further shift some of the burden of supporting the patent system away

and the value of financially inducing patentees to let their patents go into the public domain at an earlier date via substantial maintenance fees.[16]

Recognizing these factors, Congress enacted the fee structure with the goal of ultimately collecting 50% of patent fee revenues at the "front-end" (application, processing and issue fees) and 50% at the "back-end,"[17] once all maintenance periods were in effect (12 years after the law's effective date). Unfortunately, "back-end" revenues have not reached the anticipated share levels, in part due to the growing backlog of applications that have not issued as patents, which would otherwise fetch maintenance fee revenues (see Slide 7 in Attachment A).

The three rationales listed above for keeping the "front-end" fees relatively low are nowhere to be found in PTO's policy lexicons. Not only is the agency unaware of these factors as relevant, its officials are intent on pursuing fee-setting policies for administrative expediency that would *directly contravene* these goals; and Section 10 of H.R. 1249 would permit them to do so. In a white paper on patent reform jointly authored by Arti Rai (PTO's then Administrator for External Affairs), Stuart Graham (PTO's Chief Economist) and Mark Doms (Department of Commerce's Chief Economist), these officials indicated PTO's intent to increase the "front-end" fees upon receiving fee-setting authority, further skewing the existing imbalance with the "back-end" fee revenue.[18]

These officials' stated rationale has everything to do with PTO administrative convenience goals and very little to do with patent policy and the public interest. The move to increase "front-end" fees would also

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from the public to the commercial users of inventions. This feature will be helpful to small businesses and individual inventors by keeping initial patent fees low.").

[15] *Industrial Innovation and Patent and Copyright Law Amendments*, Hearings Before the Subcommittee on Courts, Civil Liberties, and the Administration of Justice of the Committee on the Judiciary, House of Representatives, 96th Congress. Statement of Sidney A. Diamond, Commissioner of Patents and Trademarks, p. 574, (April 21, 1980) ("patents provide an important means for the public disclosure of information about inventions and their uses. Although patent rights last seventeen years, the information a patent contains is available to the public immediately, and can be built upon for further advancing the frontiers of man's knowledge."); Testimony of Hon. Philip Klutznick, U.S. Secretary of Commerce, (April 3 1980) ("We believe it is fair for the general public, which benefits from the disclosure of information about an invention, to absorb 40 percent of these costs, through the appropriation of tax revenues; and for applicants and patentees to pay 60 percent.").

[16] *Id.* Statement of John C. Stedman, p. 234, (April 15, 1980) ("Maintenance fees also serve a useful purpose in clearing out the underbrush, thus simplifying the task of determining whether certain previously patented technology can or cannot be used with impunity."); statement of Sidney A. Diamond, p. 601, (April 24, 1980) ("We expect a double advantage from this. If a patent owner decides a patent is not worth the maintenance fees, he will allow it to expire earlier than it otherwise would. Because of this early expiration, the patent would go into the public domain at an earlier date. A third party might find something very useful in it.").

[17] H. Rep. 96-1307(I), 8-9 (1980) (patent applicants should bear the Office's patent costs through the payment of fees split in equal amounts between application "processing" fees and "maintenance" fees). Prior to its taking effect, the 1980 law was amended by P.L. 97-247 on Aug. 27, 1982. To effect full user funding of PTO, the latter doubled both the patent processing and the maintenance fees from the levels authorized by P.L. 96-517, maintaining their relative proportions wherein each was intended to produce 50% of the Office's patent fee revenue. The increased new fees went into effect on October 1, 1982.

[18] See *Patent Reform*, White Paper from the U.S. Department of Commerce (April 13, 2010) p. 6. At http://www.commerce.gov/sites/default/files/documents/migrated/Patent_Reform-paper.pdf ("This dependence on back-end revenues is particularly perilous in the case of maintenance fees. … This model has proven extremely difficult to manage from an accounting and planning standpoint, especially during the economic tumult of recent years.").

serve an unstated goal of suppressing filings of applications, claims and continuations – a goal which has no economic theory or empirical support and must never animate any fee-setting policy.

We have little doubt that the proposed fee-setting authority in H.R. 1249 would be taken by PTO officials as permission to "manage PTO's workload" (suppress filings of applications, claims and continuations) via the fee structure and otherwise attain public policy goals in accordance with the officials' own beliefs that have little to do with PTO's statutory role. For example, Arti Rai in her paper published before she was sworn-in as Administrator for External Affairs at PTO states that PTO's authority to set patent user fees should be used for purposes of "managing its workload" and suggests fee-skewing methods to "deter" excessive filing "behavior."[19] See also Slides 8-11 in Attachment A.

These ideas of curbing patenting activities do not end with escalating fees solely based on patent application attributes, as justifications were also invented for escalating progressive fees on entities that accumulate growing patent portfolios.[20] To be sure, all of these approaches for escalating or skewing fees would be *permissible* under the broad authority in Section 10 of H.R. 1249 as mere *apportionment* of fee components, because when averaged over all applications, they can still be shown to recover "the *aggregate* estimated costs to the Office."

Fee Setting Authority – PTO Competency and Objectivity

We also oppose granting the PTO fee-setting authority because it is an agency that demonstrated lack of competency and analytic capacity to provide objective analyses of its costs, projected workload, costs to the public and paperwork burdens it imposes on the public. The record shows that the PTO systematically conceals information that is essential for the public to evaluate its models and calculations, and the economic impact of its rules.

An illustrative example that goes directly to PTO's conduct in setting fees, ostensibly to recover actual "costs," is its effort to establish a prioritized examination track by rulemaking. Putting aside here the question whether current law permits the PTO to set this examination fee, the PTO set by rule a fee of $4,000 as an additional charge for placing an application in the prioritized examination track. It stated that this "prioritized examination fee is set based on the estimated average cost to the Office of performing the service" and that this amount is required to "recover the full cost of the necessary resources to increase the work output of the Office without delaying non-prioritized applications."[21]

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[19] Arti K. Rai, Growing Pains in the Administrative State: The Patent Office's Troubled Quest for Managerial Control, 157 *University of Pennsylvania Law Review*, 2051, 2067 (2009) ("The generally modest pace of congressional action in the patent arena does not afford the PTO the flexibility over fees that *it needs to manage its workload*"); at 2069: "a [skewed] fee structure might be put into place *to deter filing behavior* that imposes costs not only on the PTO but also on society as a whole." (Emphasis added). She even discusses price elasticity data that would be required to curb filings. Available at http://www.pennumbra.com/issues/pdfs/157-6/Rai.pdf.

[20] *Id.* at 2069-70 ("On the other hand, an argument can be made for some level of taxation in connection with patent portfolios. In this regard, a system under which firms were charged a slightly increased fee for each additional patent application they filed in any given year is an interesting possibility.").

[21] 76 Fed. Reg. 18403, Col. 1. The PTO states that given the authority, it would set the prioritized examination fee at $2,400 for small entities, and $4,800 for other entities, in accordance with cost recovery based upon fiscal year 2010 data indicating that 27.8% of new serialized utility and plant applications were by small entities. Apparently, the PTO is incapable of computing a simple weighted average: by using these fees, it would overcharge applicants and collect an average of $4,133 per prioritized application and not $4,000.

The PTO disclosed no information in the rulemaking proceedings pertaining to the number of examiners it intends to hire for the program, nor any other details on how it would ramp-up its examination capability for the program, despite public comment requests to do so. It provided no information which would have permitted an objective verification of its claim to an *additional* cost of $4,000 to process an application that is taken-up out-of-turn. This claim appears absurd on its face because average examiner hour cost to examine an application taken up out-of-turn is essentially the same as that for other applications in the standard track.

While it is true that incremental *cash* outlays to hire, equip and train additional examiners would be expended initially in substantial amounts,[22] these new examiners would not be expected to work at the PTO only one year and leave. Thus, amortizing these initial outlays over a period shorter than that which the Office uses in its normal accounting for average useful service time of an examiner would violate generally accepted cost-accounting practices. Hence, the difference in *actual incremental costs* between the prioritized and standard examination tracks should be but a small fraction of PTO's average production cost per application. According to PTO's FY 2010 Annual Report, the average production cost per application of the entire patent examination process over its pendency including the associated allocated costs ("efficiency"), is $3,471.[23] PTO's assertion that $4,000 is the *additional* incremental average cost to the Office – more than doubling the production cost per application – is highly suspect and appears to be an attempt to base fees not on cost but on what the market will bear.[24]

The PTO was not only uncooperative with public requests for information, concealing its sources and methods for producing the $4,000 cost figure during its fee-setting rulemaking process, it flouted requests by a Congressional Committee to show its work. A recent letter to PTO Director David Kappos sent by the House Judiciary Committee contained the following question propounded by Congressman F. James Sensenbrenner, Jr.:

> Please provide the *financial analysis* under standard cost-accounting practices that *shows* that the *cost* of examining an application that is selected out-of-turn for Track I processing is $4,000 more than that for an application that was left in the standard queue for examination, even though the average examination times expended on applications in either tracks are no different.[25] (Emphasis added).

The PTO Director failed to provide the *financial analysis* and *showing* as requested and instead merely repeated the opaque claims to have conducted such an analysis:

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[22] We are concerned that the initial *cash* revenue required would be paid in part from the incremental proceeds the PTO intends to collect from the 15% across-the-board surcharge fees. This would be possible because all maintenance fee surcharges would be recognized immediately as revenue whereas prioritized examination fees cannot be so recognized until patent grant, when the work is completed.

[23] *United States Patent and Trademark Office Performance and Accountability Report FY 2010*, at 20. Patent efficiency is a measure of cost of the entire patent examination process over time including the associated allocated costs, or the efficiency with which the organization applies its resources to achieving its performance goals. The measure is determined by comparing the total direct and indirect expenditures attributed to patent operations and support activities compared to the number of outputs or applications granted and abandoned.

[24] Even if the $4,000 incremental cost figure is not merely made up based on applicants' willingness to pay to accelerate their application, this result – of more than doubling the standard cost of examination – should be of great concern to Congress and a closer review of PTO procedures that produce such costs are warranted – not a blank check for PTO to collect these exorbitant fees.

[25] Letter from Lamar Smith, House Judiciary Committee Chairman to David Kappos, PTO Director, Questions for the Record, (April 13, 2011) at 4, attached hereto in Attachment B.

> The financial analysis supporting the calculation of the fee was accomplished in two steps. The Office first determined the estimated work required to prioritize applications. Next, the Office identified the direct cost for achieving that work required and applied the indirect-cost-burdening rate calculated from the Office's historical activity based on cost accounting information to calculate the full cost for implementing the prioritized examination process.
>
> Track I participants are essentially paying to receive expedited review without impacting the review of non-expedited applications. Thus, Track I requires additional funding to pay for the examination of Track I applications, to pay for the hiring of new examiners and/or overtime, without delaying examination of non-Track I applications.[26]

The absence of evidence of an objective analysis is prima facie evidence of the absence of any objective analysis. This PTO non-response and the lack of accountability and transparency in the wake of its information-stealth fee-setting rulemaking exercise, is a preview of what would become routine under the legislative regime proposed in Section 10 of H.R. 1249. The public notice and comment period provided in the legislation is supposed to enable the public to meaningfully participate in a PTO fee-setting rulemaking. Today, the PTO is notoriously dismissive of its disclosure responsibility and in its treatment of public comment, which engenders little confidence that it will do any better if it is given even more rulemaking authority tomorrow.

It is important to recognize that discharging fairly the fee-setting responsibility by rulemaking would require the PTO to publish information and data in objective and unbiased manner, showing its costs, disclosing the financial models it uses to derive its cost estimates, and to do so in compliance with the Information Quality Act (IQA).[27] Without these components, the public notice and comment protections of the rulemaking process would be eviscerated.

Government-wide information quality guidelines published by OMB, to which every agency must adhere,[28] provide that "agencies *must make their methods transparent* by *providing documentation*, ensure quality by reviewing the underlying methods used in developing the data and *consulting* (as appropriate) with experts and users, and keep users informed about corrections and revisions."[29] But the PTO now has a record showing that it would do nothing of the sort, for it pays no attention whatsoever to the information quality standards in its own guidelines and ignores its public implementation commitment. This is illustrated in a series of public notice and comment proceedings and particularly in one that dealt with applicants' fees and burdens imposed by the PTO on applicants filing patent applications. In 2010, PTO published for public comment and submitted to OMB for approval its paperwork burden estimates that it will impose on the public in preparing and submitting initial patent applications during the three-year period 2011-2013. The PTO's "estimates" were inscrutable, lacking in objective support and incapable of being independently reproduced.

Therefore, a private party formally petitioned the PTO to correct these obvious IQA defects and provide the missing information.[30] The request for correction (RFC) identified a series of gross errors including a flawed statistical analysis method that produced an error of at least $1.35 billion over three years. In its

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[26] Letter from David Kappos, PTO Director, to House Judiciary Committee, Answers to Questions for the Record, (May, 2011), at 4, attached hereto in Attachment B.

[27] 44 U.S.C. § 3516 note, Treasury and General Government Appropriations Act for Fiscal Year 2001, Pub. L. No. 106-554, § 515 (2001).

[28] Office of Management and Budget, "Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies; Notice; Republication, 67 Fed. Reg. 8452-8460, (February 22, 2002).

[29] 67 Fed. Reg. 8453, Col. 2, (emphasis added).

[30] Ron D. Katznelson, Request for Correction under the IQA, (Nov. 23, 2010). At http://j.mp/IQA-RFC

reply,[31] the PTO wrote about most of the elements, advanced explications supported by no logic or established analytical methods, failed to respond to each of the error correction requests in the RFC, and arrogantly refused to make *any* corrections. The requester then appealed[32] this PTO decision, as provided for in OMB's and the PTO's information quality guidelines, systematically documenting every error in the PTO's reply. But the PTO denied the Appeal with a single paragraph:

> I find that [the original PTO response to the RFC] fully and accurately contemplated all matters now on appeal before me. To the extent any new matter is raised on appeal, I do not find your arguments to be persuasive. Because no correction is warranted at this time, I must deny your appeal.[33]

It is unconscionable for a responsible Federal agency to issue such a dismissive final reply that is unresponsive on every question raised in the appeal. If the PTO cannot behave responsibly in a relatively small matter such as an IQA petition, there is no credible basis for believing that it will not behave just as irresponsibly when setting fees. The proposed legislation in H.R. 1249 contains absolutely no safeguards to prevent this from happening.

Moreover, having established a track record of abusing the public trust on small matters, the PTO could reasonably infer that Congress does not care if it abuses the public trust on larger matters, such as fees. The most charitable conclusion is that the PTO has no expertise or analytic capacity to provide an objective analysis that would inform the PTO Director to exercise his delegated authority for setting fees. Enacting Section 10 of H.R. 1249 will guarantee numerous challenges under the Administrative Procedures Act of PTO arbitrary and capricious fee rules. For these reasons and those described in the Policy section, Congress cannot, and should not, delegate fee-setting authority to the PTO without a complete overhaul of the safeguards and inclusion of detailed policy directions within the statute.

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[31] PTO Response to Katznelson's RFC, (Jan. 21, 2011). At http://j.mp/IQA-Response .
[32] Ron D. Katznelson, Appeal of PTO Rejection of RFC, (March 22, 2011). At http://j.mp/IQA-Appeal
[33] PTO Denial of Katznelson's IQA Appeal (May 19, 2011). At http://j.mp/IQA-Denial.

ATACHMENT A

Patent Legislation

Positions on Patent Office Funding Bill

June, 2011

Participating organizations on this issue

- IEEE-USA
- IP Advocate
- National Association of Patent Practitioners
- National Congress of Inventor Organizations
- National Small Business Association
- Professional Inventors Alliance USA

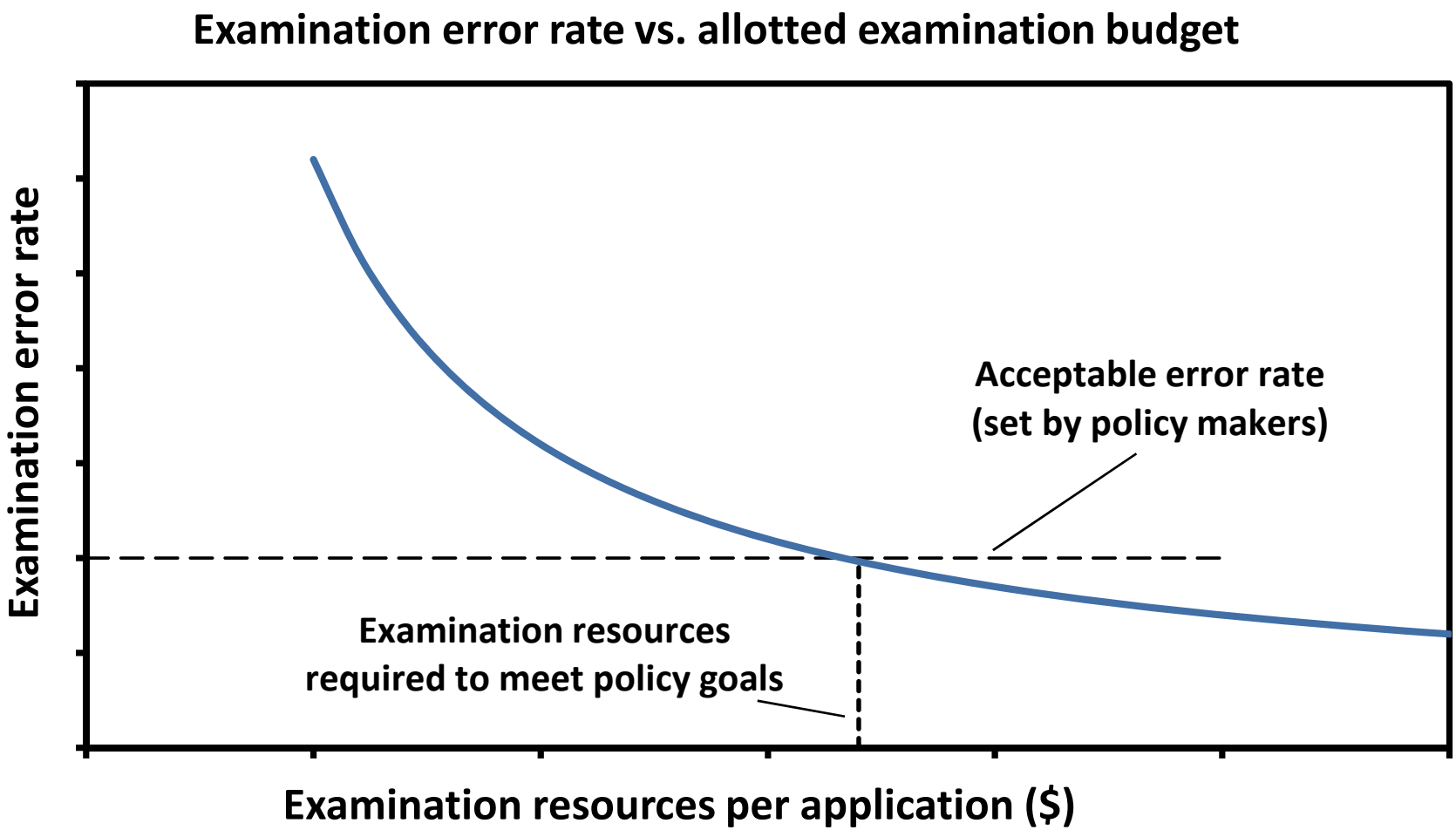
Strongly support USPTO Standalone funding bill

- We support a standalone funding bill. USPTO needs funding legislation that is not held hostage to Patent Reform legislation
- Essential components of USPTO funding legislation:
  - Immediate appropriation to cover the Office's funding shortfall, possibly using aggregate fees previously diverted from the Office
  - Statutory end to fee diversion
  - Requiring the USPTO to work with Congress on a new *fee evolution model* and appropriate ***predetermined fee adjustment framework*** based on actual cost indicators
  - Substantial concerns about insufficient safeguards in the broad fee-setting authority granted to USPTO under the new bill

Essential policy aspects of patent fee-setting are outside of USPTO's institutional role and expertise – requiring tight safeguards

- The USPTO has neither the economic competence, nor mandate, nor institutional ability to
  - be a neutral disinterested policy-balancer, to set fees at an economically efficient level because it has prima facie conflict and a direct administrative stake in the outcome;
  - balance between patent application examination costs and acceptable economic harm due to examination errors – i.e., to set examination error rate goals and related costs to achieve these goals;
  - determine the fraction of fees to be collected at the "front-end" as opposed to "back-end" renewal fees; and to
  - model and project patent application attributes (size, claims, continuations) necessary to achieve patent protection

Although USPTO can determine the cost for achieving given examination error rate goals, it has no economic expertise or ability to determine the economically *acceptable level* of error rates and thus the goal for average examination resources per application

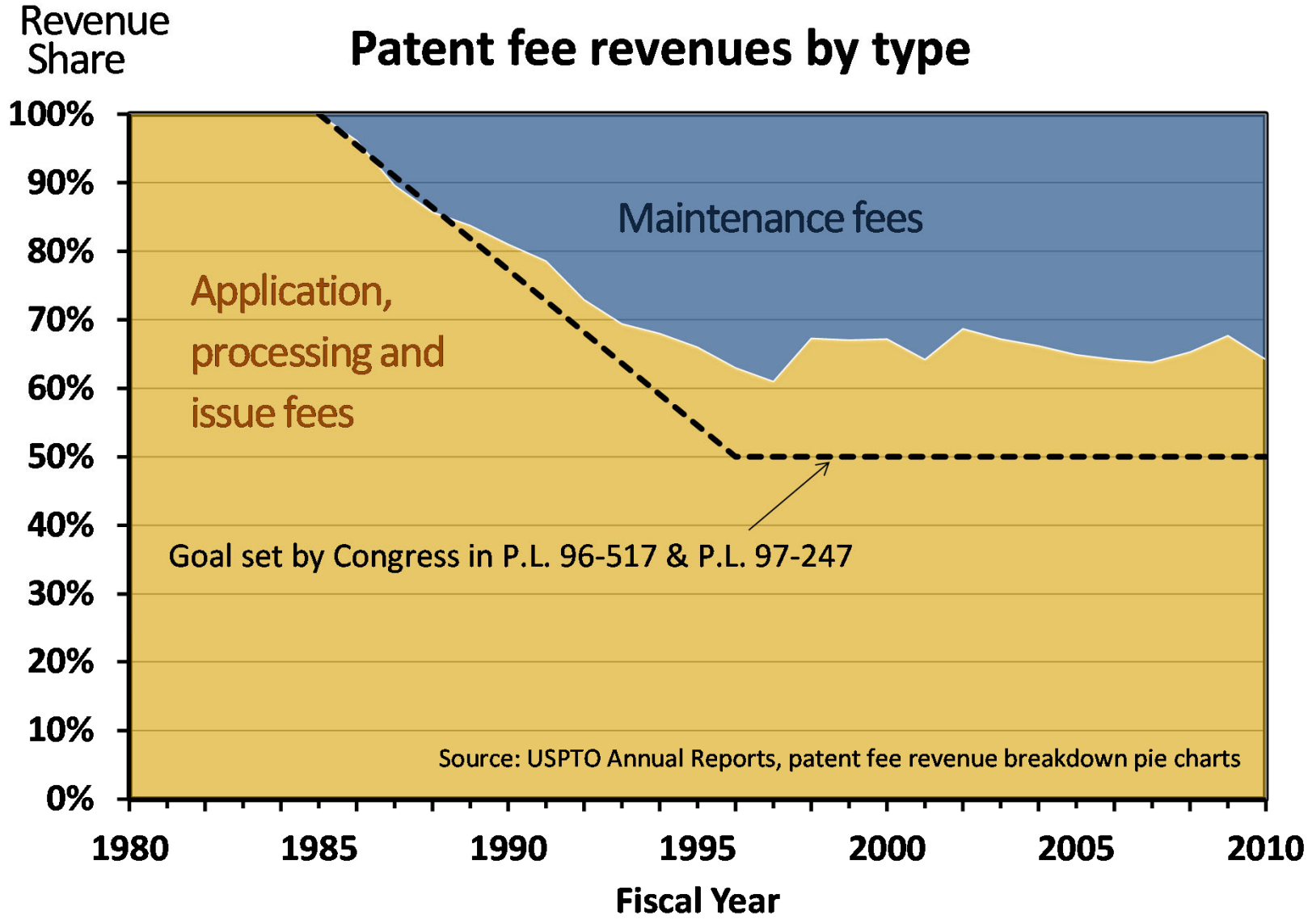


USPTO lacks expertise to determine the optimal share of fees to be collected at the "front-end"

- Under current statute, USPTO is allowed to collect only a fraction of the patent fees at the "front-end" (before patent grant)
  - Enables applicants to defer patenting costs until they achieve commercial success – supports startups.
  - Fosters more disclosure – even from ultimately unsuccessful applicants.
  - Stronger incentives for early termination of useless patents – reduces IP barriers for others
- USPTO indicated that, given fee-setting authority, it intends to ***increase front-end fee share*** despite its lack of expertise for determining the adverse economic effects of such temporal costs shift on patentees and the innovation economy.[1]

1. See *Patent Reform*, White Paper from the U.S. Department of Commerce (April 13, 2010) p.. 6.. At http://www.commerce.gov/sites/default/files/documents/migrated/Patent_Reform-paper.pdf ("This dependence on back-end revenues is particularly perilous in the case of maintenance fees. … This model has proven extremely difficult to manage from an accounting and planning standpoint, specially during the economic tumult of recent years.")

With its new fee-setting authority, USPTO proposes to *increase* front-end fees' share even more, deviating *further* from original Congressional intent



Concerns about USPTO fee-setting authority

- Agency tendencies for using fees to achieve policies directed at administrative goals rather than sound economic patent policy goals
- Concern about broadly authorizing the USPTO to set fees based on "aggregate" costs under the proposed patent bill
  - Aggregate Cost is undefined
  - Cost across all applications/users? Total cost? Cost of each item or category in an application?
  - Does not preclude skewing fee structure to achieve policy goals that are best left to Congress
- Would the Claims and Continuation limits rules that were struck down by the court come back de-facto via escalating fee structures designed to control "applicants' behavior"?

U.S. Patent Office record of attempting to control applicants' behavior by fees, limiting patent rights

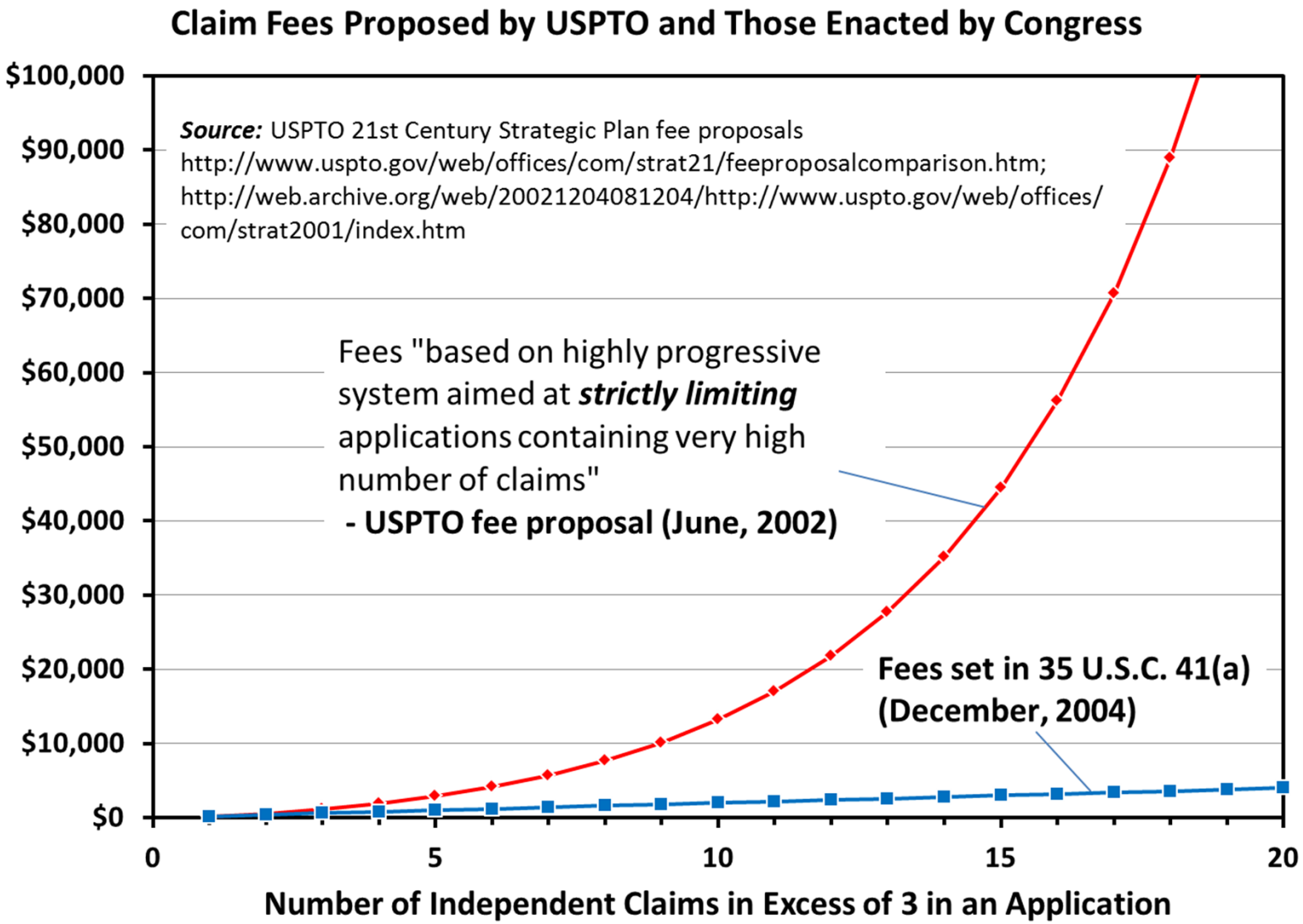
- *Annual Report of the Commissioner of Patents*, 3, (**1928**) (Of surcharge fee in excess of 20 claims: "The object of this [surcharge fee] was not to bring in revenue but ***to decrease the unnecessarily large number*** of claims filed with applications.")
- *Annual Report of the Commissioner of Patents*, 5 (**1965**) (Study initiated to consider changes in the Rules of Practice ***to limit*** "the length of patent specifications and the number and nature of patent claims.")
- 63 *Fed. Reg*. 53497, 53507 (Oct. 5, **1998**) ("this problem [of] applications containing an excessive number of claims has been exacerbated by the advent of word-processing equipment, ….it is now time for the PTO to act ***to limit*** the use of excessive numbers of claims in an application.")
- *USPTO 21st Century Strategic Plan*, fee proposal (June **2002**) (Fees "based on highly progressive system ***aimed at strictly limiting*** applications containing very high number of claims.")

U.S. Patent Office record of attempting to control applicants' behavior, limiting patent rights (Contd.)

- USPTO Information Collection Request in support of Claims and Continuation limitation Rules, Supporting Statement at 2, 200512-0651-002 (Dec. 22, **2005**) ("A small but significant minority of patent applications [ ] contain an ***excessive*** number of claims." … "a small minority of applicants has ***misused*** these practices by filing multiple continuing applications and requests for continuing examination in order to delay the conclusion of examination.")
- 71 *Fed. Reg*. 48, 49 (Jan. 3, **2006**) ("it is now appropriate for the Office to clarify the applicant's duty … by ***placing some restrictions*** on the filing of multiple continuing applications")
- 71 *Fed. Reg*. 61, 62 (Jan. 3, **2006**), ("The Office is now proposing changes to its practice for examination of claims …[that] does share with an applicant who presents ***more than a sufficiently limited number*** of claims for simultaneous examination the burden so imposed.")
- 72 *Fed. Reg*. 46716 (Aug. 21, **2007**)[Final rules ***limiting*** claims and continuations. Struck down by *Tafas v. Dudas, 541 F.Supp.2d 805* (E.D. Va. 2008)]

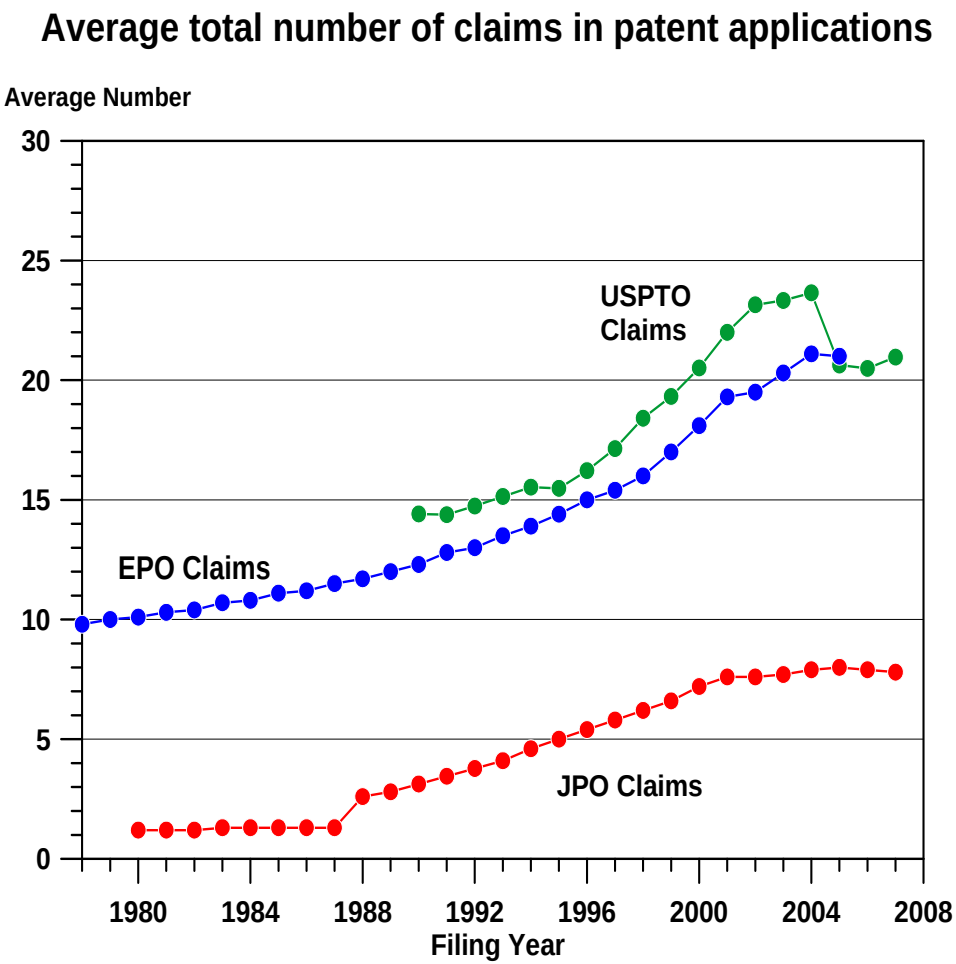
Vesting with USPTO fee-setting power?

– The alarming historical precedent



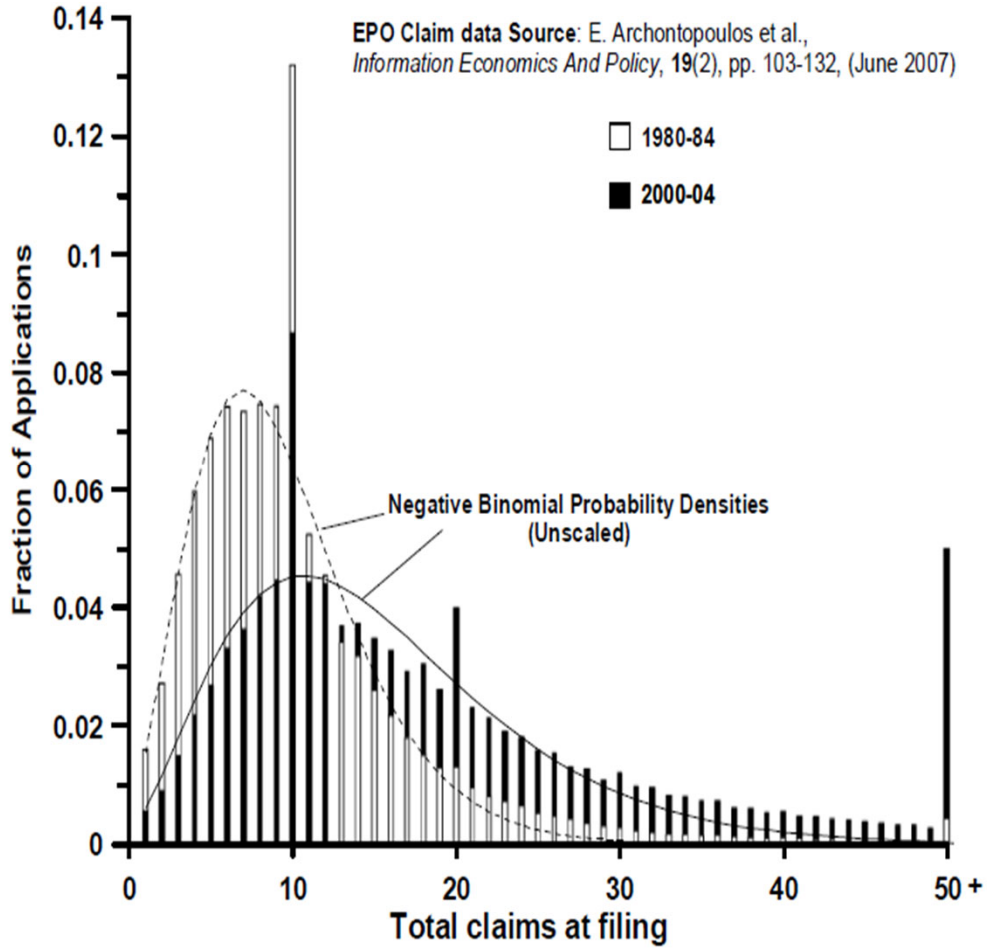
USPTO is ill-equipped to determine what constitutes an "excessive" number of claims

- USPTO's expertise is limited to ***patentability analysis*** – not infringement analysis
- Applicants draft multiple claims to cover ***infringing*** products
- Due to claim-scope erosion, weakening of the doctrine of equivalence and increasing technology complexity, a larger number of claims are ***required*** for appropriating equivalent returns from inventions – an economic trend which the USPTO is ill-equipped to analyze.



USPTO is ill-equipped to determine what constitutes an "excessive" number of claims (Contd.)

- Dramatic rise over two decades in the fraction of applications having large number of claims
- Due to claim-scope erosion, weakening of the doctrine of equivalence and increasing technology complexity, a larger number of claims are required for appropriating equivalent returns from inventions – an economic trend which the USPTO is ill-equipped to analyze.



CONCLUSIONS

- While USPTO can advise Congress on costs to achieve certain levels of examination error rates, it lacks the expertise and authority to determine the desirable balance between the cost and quality of examination and the factors that apportion these costs over time and over applicant entity size categories.
- USPTO lacks competency for fee *apportionment*
- Congress must retain the full power to set fees based on inputs from industry experts, innovation economists and from USPTO

ATACHMENT B

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LINDA T. SÁNCHEZ, California
DEBBIE WASSERMAN SCHULTZ, Florida

April 13, 2011

The Honorable David Kappos
Undersecretary of Commerce for Intellectual Property and
Director of the United States Patent and Trademark Office
United States Patent and Trademark Office
600 Dulany Street
Madison West Building, 10-D-44
Alexandria, VA 22314

Dear Director Kappos,

I am writing to request that you respond to the following questions, submitted by Rep. F. James Sensenbrenner, Jr., for inclusion in the March 30 hearing record on the "America Invents Act."

Section 2 (Grace period and first-to-file)

In page 2 of your prepared statement, you say that "the proposed transition of the U.S. to a first-inventor-to-file system [is] an essential feature of any patent reform legislation," while stressing how rare interferences are.

(a) If, as you assert, the number of cases affected by this proposed change is so small (number of interferences are only 0.01 % of the number of applications), how could such a legislative change be so important so as to become "an *essential* feature of any patent reform legislation"?

Having seen the specific explanations of groups of small businesses, startups and individual inventors making up the Small Business Coalition on Patent Legislation from whom you received a letter explaining that their concern is the loss of the grace period and not interferences, you nevertheless appear to dismiss their concerns by stating on page 2 that "[s]ome contend that the proposed transition will only benefit large patent owners, to the disadvantage of independent inventors, and would encourage a rush to the patent office with hastily drafted patent applications. This fear is unfounded, and inconsistent with the facts."

(b) What "facts" does the Office have which are "inconsistent" with small business, startups and individual inventors assertions that the weakening of the grace period will disadvantage them by harming their development process and their ability to raise funding for developing their inventions?

(c) What evidence does the Office have to show that this "fear is unfounded"? Please provide any studies or evidence collected by the Office that characterize the processes that small business and startups go through in developing their inventions, disclosing to strategic partners and raising money before filing their patent applications that shows that the "fear is unfounded."

During your testimony, you suggested that the reason for a transition to the first-to-file system is to "reduce legal costs, improve fairness, objectivity and transparency," referring to the evidentiary complexity and costs of interference, while at the same time you also argue for adoption of prior user rights. The prior user right system, however, requires a determination of prior use and first-inventorship, which is merely a recharacterization of interference practice; it will impose many of the same evidentiary burdens and complexities that are characteristic of interference practice and that disproportionately create more burdens on small businesses, start-ups, independent inventors, and non-profits.

(d) Can you explain why it is so important to eliminate such evidentiary burdens and complexities in interferences only to adopt them in administrating prior user rights proceedings?

Section 4 (Prior user rights)

On page 4 of your prepared statement, you testified that "Expanding the prior user defense, I believe, is pro-manufacturer, pro-small business, and, on balance, good policy." You have also said in your testimony that "prior user rights have the advantage of being very pro-American manufacturing" as it would end the "incentive for American businesses to locate their factories overseas" because the proposed U.S. prior user rights in the legislation would permit them to move their factories to the U.S. under this new shield from infringement liability. But prior user rights under this bill also confer benefits to prior use anywhere in the world with no advantages to domestic users. Why then would anybody move their manufacturing facilities to the U.S. when they can escape liability under a U.S. law that recognizes prior use in their existing foreign facilities? In fact, there are significant disincentives for moving or building such facilities in the U.S. because doing so would kill the current protections these manufacturers enjoy under foreign prior user rights laws – laws which only protect them for prior use within their respective jurisdictions.

(a) Please provide the data and reasoned analysis that supports your testimony that "prior user rights have the advantage of being very pro-American manufacturing."

(b) Please provide an analysis of foreign prior user rights laws, indicate whether these laws are harmonized, and provide an analysis of how Section 4 of H.R. 1249 compares to these laws.

(c) Is it the position of this Administration that the prior user rights proposed in this legislation is "pro- manufacturer, pro-small business, and, on balance, good policy"?

Section 9 (Fee Setting Authority)

Among other provisions, this section of the bill would grant you authority to adjust or set patent user fees authorized or charged under 35 U.S.C. § 41. However, this week I learned that you believe that the authority contemplated by the bill may be unnecessary somehow. You have just promulgated a new rule published in the Federal Register that increases patent examination fees in certain instances by $4,000, where Congress authorized under 35 U.S.C. § 41(a)(3) and 35 U.S.C. § 41(f) that patent examination fees be set to $220 ($110 small entity) in all instances.

The published rule seems to have discovered the authority of the PTO to set different fees for examination in 35 U.S.C. § 41(d)(2). However, this section merely provides as follows:

41(d)(2) "OTHER FEES. - The Director shall establish fees ***for all other*** processing, services, or materials relating to patents ***not specified in this section*** to recover the estimated average cost to the Office of such processing, services; or materials..." (emphasis added).

But examination fees ***are*** "specified in this section" (in § 41(a)(3)). Current law simply commands that "[t]he Director shall cause an examination to be made of the application and the alleged new invention," and that for doing so, the "[t]he Director ***shall*** charge the following fees: (3) examination fees..."

In order that the Committee better understand your views regarding the contours of the fee-setting authority you believe the PTO Director already has under *current* law, please provide the following:

(a) The analysis and reasoning the Office relied on in promulgating the Track I examination fees under this new rule, showing how it derived an existence of PTO fee-setting authority to set examination fees in variance with those specified in § 41(a)(3).

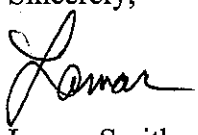
(b) The analysis and reasoning that the Office relied on in concluding that it has the authority to divert resources (at least in FY 2011) and delay timely examination of applications of those who could not afford the higher fees of Track I in order to accelerate out-of-turn examination of applications of those who can afford to pay the extra $4,000 for Track I.

(c) The financial analysis under standard cost-accounting practices that shows that the *cost* of examining an application that is selected out of turn for Track I processing is $4,000 more than that for an application that was left in the standard queue for examination, even though the average examination times expended on applications in either tracks are no different.

(d) An explanation of why the cost-accounting rationale and reasoning relied on in (c) above to explain the higher costs when PTO hires and trains an increased number of new examiners would not also compel the PTO to *reduce* the fees whenever it reduces or halts the hiring and training of new examiners.

I would appreciate receiving your responses by May 13. Thank you for participating in the March 30 hearing and for your hard work at the USPTO.

Sincerely,



Lamar Smith
Judiciary Committee Chairman

LS/bsm

Representative F. James Sensenbrenner, Jr.
Questions for the Record

David J. Kappos
Under Secretary of Commerce for Intellectual Property and
Director of the U.S. Patent and Trademark Office

Follow-up from IP Subcommittee Hearing on March 30, 2010, on the "America Invents Act"

Section 2 (Grace period and first-to-file)

2(a) If, as you assert, the number of cases affected by this proposed change is so small (number of interferences are only 0.01% of the number of applications), how could such a legislative change be so important so as to become "an *essential* feature of any patent reform legislation"?

Whether instituted before the USPTO or arising during litigation, disputes over who was the first to invent have unnecessarily complicated and burdened the process of acquiring and asserting rights in an invention. Transitioning to a first-inventor-to-file system will dramatically simplify that process, significantly reduce the cost of acquiring and defending a patent, and put needed investment capital within the reach of small inventors much sooner. Under the Act, to establish priority in an invention, an inventor need only file a patent application disclosing that invention. One way to do this is to file a provisional application which costs only $110. By contrast, an interference proceeding costs upwards of $500,000.

Moreover, in this global economy, harmonization of U.S. laws with those of every other nation will further support U.S. innovators seeking to market their products and services overseas. That will also protect some individual inventors and small businesses from losing rights to their invention overseas. By changing to a first-inventor-to-file system, U.S. inventors unaware that our trading partners determine priority based on who files first, will not be mislead into believing that they can delay filing overseas and establish priority there based on earlier conception.

While the number of applications involved in interference proceedings is a small percentage of the total number of pending applications, the impact on innovators, both here and overseas, extends far beyond interferences. Transitioning to a first-inventor-to-file system, with appropriate safeguards to protect inventors whose work has been stolen and claimed by others, is an essential component of patent reform.

2(b) What "facts" does the Office have which are "inconsistent" with small business, startups and individual inventors assertions that the weakening of the grace period will disadvantage them by harming their development process and their ability to raise funding for developing their inventions?

The transition to first-inventor-to-file will make it easier for small business, startups and individual inventors to obtain rights and raise funding for developing their inventions. Even today, innovators armed with a pending patent application fare better in the system than those who have not yet submitted an application. With an early filing date, those applicants limit their litigation exposure and are more likely to secure funding to develop their invention. The first-inventor-to-file system would make it more certain that the inventor who filed first will be granted a patent, and even more likely to withstand a challenge in the USPTO or a court proceeding. The system encourages early disclosure of new inventions, making it easier for investors to plan their technology investments without fear of interceding rights holders.

As to an inventor's own disclosures, the Act provides a more transparent and certain 12-month grace period than under current law. Specifically, an inventor's public disclosure made within the 1-year grace period prior to filing a patent application will not prevent that inventor from obtaining a patent. This disclosure also serves to create prior art that can prevent others from obtaining rights on that same claimed invention. Finally, it is our understanding that the legislative intent of the section is to ensure that an applicant will not lose any rights based on non-confidential disclosures – or even private offers to sell – to investors and venture capital companies during the grace period.

2(c) What evidence does the Office have to show that this "fear is unfounded"? Please provide any studies or evidence collected by the Office that characterize the processes that small business and startups go through in developing their inventions, disclosing to strategic partners and raising money before filing their patent applications that shows that the "fear is unfounded."

The Act is designed to benefit all, independent inventors and large patent owners alike. As to independent inventors and other small businesses, the current system exposes them to the risk of being pulled into an expensive and complex interference proceeding at the USPTO, that can cost upwards of $500,000. Litigating the issue in district court costs even more. By contrast, for the cost of filing a provisional application, a mere $110, under the Act an inventor can obtain a filing date without fear that his or her application will be challenged by a prior inventor who kept their invention secret. While small entities cannot always afford to patent every technical improvement they make, the Act's prior user rights will protect them from large competitors with extensive patent portfolios of later patent filings. Thus, the fear that the Act will only benefit large patent owners is unfounded. Similarly, there is no reason to believe that applicants will be so rushed to obtain an earlier filing date as to file incomplete applications.

Our position was informed based on countless meetings with stakeholders over the last 18 months, and recommendations by various academic and U.S. Government studies dating back to 1966. The 2004 National Academies, in its report "A Patent System for the 21st Century" recommended a shift to a first-inventor-to-file system to reduce uncertainties and unnecessary costs borne by innovators. Both reports on the patent system issued by the Federal Trade Commission – in 2003 and 2011 as the current legislative proposal was being discussed – also recommended the transitioning to a first-inventor-to-file system. And even earlier, the 1992 Advisory Commission Report on Patent Law Reform and the 1966 Report of the President's Commission on the Patent System made the same recommendation.

2(d) Can you explain why it is so important to eliminate such evidentiary burdens and complexities in interferences only to adopt them in administrating prior user rights proceedings?

By eliminating the evidentiary burdens required to establish prior invention, the first-inventor-to-file system simplifies the process of obtaining a patent and reduces legal costs. By allowing manufacturers who first adopt technology to continue making products that predate the filing of an application by another, these rights promote fairness, protect investments in manufacturing, encourage businesses to invest in the U.S., protect small businesses and independent inventors from large competitors with extensive patent portfolios, and much more.

<u>Section 4 (Prior User Rights)</u>

4(a) Please provide the data and reasoned analysis that supports your testimony that "prior user rights have the advantage of being very pro-American manufacturing."

Currently, businesses enjoy stronger protection overseas, where the availability of a prior user defense in litigation protects capital expenditures in many other nations. Expanding the current prior user defense in the U.S. would level the playing field for those companies deciding whether to establish and maintain

manufacturing facilities in the U.S. Moreover, stakeholders have repeatedly expressed their view that prior user rights support American manufacturing.

Absent such a defense, the only alternative available to the prior user in litigation would be to engage in costly litigation to invalidate the patent. To prevent litigation abuse, the reported bill also goes further than current law to ensure that the prior user must both reduce to practice and commercialize his invention more than a year before the applicant files a patent application.

Finally, section 3(m) of the reported bill requires that within four months after enactment, the USPTO will submit a report to Congress with findings and recommendations on the operation of prior user rights in certain industrialized countries including the effect of prior user rights on innovation rates in those countries. We believe an analysis of the effect of prior user rights in other countries will show that they protect and even encourage investment in local manufacturing.

4(b) Please provide an analysis of foreign prior user rights laws, indicate whether these laws are harmonized, and provide an analysis of how Section 4 of H.R. 1249 compares to these laws.

With the exception of the United States, almost all of the countries in the world provide prior user rights as part of their patent laws. The implementation of prior user rights varies country-to-country, but, in each of these countries, prior user rights are designed to provide a limited, personal defense against charges of patent infringement by a second inventor, but do not invalidate the patent rights of the second inventor. Section 5 of H.R. 1249, as reported, entitled "Defense to Infringement Based on Earlier Inventor," similarly creates a limited, personal defense against charges of patent infringement by another inventor based on the accused infringer's earlier activities performed in the United States.

Section 3(m) of the reported bill further requires that the report on the operation of prior user rights in certain industrialized countries include a comparison of the laws of the U.S. with those of other industrialized countries. As required, we will provide the requested analysis in that report.

4(c) Is it the position of this Administration that the prior user rights proposed in this legislation is "pro-manufacturer, pro-small business, and, on balance, good policy"?

Yes, it is the position of this Administration that the prior user rights provision proposed in this legislation is pro-manufacturer, pro-small business, and, on balance, good policy. Prior user rights allow manufacturers to invest in technology with confidence and continue making products that predate a patent application filed later by another party. These rights will also protect small businesses, which may not be able to bear the cost of procuring a patent on every technical improvement they make, from large competitors with extensive portfolios of patents issued from later applications. These rights promote fairness, protect investments, encourage investment in the U.S., level the playing field against foreign competition, protect small businesses, and more. As such, their inclusion in the reported bill is, on balance, good policy.

<u>Section 9 (Fee Setting Authority)</u>

Please provide the following:

9(a) The analysis and reasoning the Office relied on in promulgating the Track I examination fees under this new rule, showing how it derived an existence of PTO fee-setting authority to set examination fees in variance with those specified in § 41(a)(3).

The Office agrees that its current authority to set fees does not permit the Office to change or set fees for services that are already specified in 35 U.S.C. § 41, including the examination fees at 35 U.S.C. § 41(a)(3). However, as you point out, under 35 U.S.C. § 41(d)(2), the Office has the authority to set fees for all other patent-related services "not specified" in section 41.

Track 1 examination fees would be used to cover the cost of allowing applicants to prioritize review of their application **without delaying** the examination of all other pending applications. To accomplish this objective, the Office must devote additional resources to build its overall capacity to work on prioritized applications. Hence, the authority for setting the fee for Track 1 is found in 35 U.S.C. § 41(d)(2), and is not in conflict with those fees specified in 35 U.S.C. § 41(a)(3). See *Federal Register*, Vol, 76, No. 64, page 18402 (Apr. 4, 2011).

9(b) The analysis and reasoning that the Office relied on in concluding that it has the authority to divert resources (at least in FY 2011) and delay timely examination of applications of those who could not afford the higher fees of Track I in order to accelerate out-of-turn examination of applications of those who can afford to pay the extra $4,000 for Track I.

As detailed in the *Federal Register* Notice announcing this initiative, the cost recovery fee was set to enable the Office to build examination capacity to prevent delay in the examination of non-Track I applications. Specifically, Track I requires funding to pay for the additional examination necessary to review Track I applications without delaying examination of non-Track I applications. Although Track I examination was scheduled to go into effect on May 4, 2011, due to funding limitations, the program has been put on hold until such time as the USPTO receives the necessary spending authority.

9(c) The financial analysis under standard cost-accounting practices that shows that the cost of examining an application that is selected out of turn for Track I processing is $4,000 more than that for application that was left in the standard queue for examination, even though the average examination times expended on applications in either tracks are no different.

The financial analysis supporting the calculation of the fee was accomplished in two steps. The Office first determined the estimated work required to prioritize applications. Next, the Office identified the direct cost for achieving that work required and applied the indirect-cost-burdening rate calculated from the Office's historical activity based on cost accounting information to calculate the full cost for implementing the prioritized examination process.

Track I participants are essentially paying to receive expedited review without impacting the review of non-expedited applications. Thus, Track I requires additional funding to pay for the examination of Track I applications, to pay for the hiring of new examiners and/or overtime, without delaying examination of non-Track I applications.

9(d) An explanation of why the cost-accounting rationale and reasoning relied on in (c) above to explain the higher costs when PTO hires and trains an increased number of new examiners would not also compel the PTO to *reduce* the fees whenever it reduces or halts the hiring and training of new examiners.

The cost recovery fee is charged to allow the Office to prioritize examination of an application, without impacting the examination of patent applications not being examined under the Track 1 program. This includes, but is not limited to, hiring and retaining more examiners to increase overall output. The same principle applies to the expedited examination of design applications from 37 C.F.R. § 1.155, discussed at 9(a), above. The § 1.155 service requires less staff time than the Track 1 service, so the fee is less, but it represents a similar need to hire additional people.

The Office currently lacks authority to adjust many of its fees which are defined by statute (see 35 U.S.C. §41) if overhead or other personnel costs go up or down over time. Fee setting authority, as provided in Section 10 of the reported bill, would enable the Office, in consultation with its stakeholders and public advisory committees, to make sense of and adjust a mix of statutory and regulatory fees.