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This nation's Founding Fathers understood the significance of innovation to America's economic growth and prosperity. They recognized that true innovation requires the same incentives, and warrants the same rights and remedies, as other forms of physical property. These principles — and the foundation of our patent system — are reflected in Article 1, Section 8 of the U.S. Constitution, which gives Congress the power “[t]o 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.”

The U.S. patent laws, first codified in 1790, were developed in order to encourage inventors to disclose their inventions to the public in return for a period of exclusive rights to their patented inventions. The patent itself is a property right granted to an inventor for his or her invention. The specific property right conferred by the grant of the patent is the right to exclude others from making, using, offering for sale, or selling the invention in the U.S. or importing the invention into the U.S. It is not the right to utilize the invention itself. The patent is issued by the U.S. Patent and Trademark Office (USPTO), and the term of a new patent is generally for 20 years from the date on which the application for the patent was filed in the U.S.

The public disclosure of inventions, which is required with the grant of a patent, encourages inventors to share their inventions rather than to keep them private. This sharing of ideas, in turn, encourages further innovation by allowing other inventors to develop improvements and next generation technologies.¹

Patents are absolutely crucial to fostering invention, innovation, and investments, all of which are essential to the core strength of our nation's competitiveness in the global economy. This intellectual property protection creates new industries, helps bring new products and services to market, and creates new jobs. Without such protections, the value of assets decreases, uncertainty in the legal rights in new products increases, and costly litigation is more likely to occur. Our nation's economy depends on enforceable patents as effective mechanisms that protect new ideas and investments in innovation and creativity. In fact, our patent laws are far more important to the U.S. today, when our comparative advantage lies in innovation, rather than in earlier periods when our natural resources and manufacturing were our primary advantages.

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¹*Patent Reform: The Future of American Innovation: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 110-149 (2007) (statement of Bruce G. Bernstein, Chief IP and Licensing Officer, InterDigital Commc'ns), available at

http://judiciary.senate.gov/hearings/testimony.cfm?id=e655f9e2809e5476862f735da1295b3d&wit_id=e655f9e2809e5476862f735da1295b3d-2-1.

I. What Are USPTO User Fees?

As mentioned above, the USPTO is the federal agency that processes patent and trademark applications, disseminates patent and trademark information, and administers the laws relating to patents and trademarks. Since 1990, the USPTO has been entirely funded through the payment of patent and trademark application and user fees. These fees paid by users of the patent and trademark systems are referred to as “USPTO user fees.” Before 1990, taxpayers supported the operations of the USPTO. Such support was eliminated in 1990 with the passage of the Omnibus Reconciliation Act of 1990 (OBRA). OBRA imposed a significant fee increase on America’s inventors in order to replace the taxpayer support the USPTO was then receiving. The revenues generated by this fee were collected by the USPTO and transferred into an account in the general Treasury. The USPTO was required to ask permission of the Congressional Appropriations Committees to use the revenues in the account.

II. What is meant by “Diversion” of USPTO User Fees?

The bilateral fee transfer process — where the USPTO user fees are deposited into the Treasury and the agency is then funded by annual congressional appropriations — has provided the opportunity for Congress to divert user fees away from the USPTO and toward federal governmental programs and operations that are entirely unrelated to the agency. According to the Intellectual Property Owners Association, the total amount of user fees collected by the USPTO which the agency was not allowed to use is over \$900 million.²

III. Why is Diversion of PTO User Fees a Problem?

Diversion of PTO user fees is a problem for practical as well as philosophical reasons.

As for the practical reasons, the goal of our patent and trademark protection system is to advance protection of significant innovation in an efficient and timely manner. An efficient patent and trademark system creates greater incentives for innovators by reducing the cost of obtaining key legal protections necessary to make investment in innovation worthwhile for the inventor. However, according to several studies, the USPTO, numerous stakeholders and congressional witnesses, fee diversion has made the U.S. patent system less efficient and more costly by contributing to the growing number of unexamined patent applications (“backlog”), and the significant time it takes to have a patent application examined (“pendency”).

The USPTO states that the total number of patent applications pending is over 1.16 million, with over 718,000 of those waiting for a patent examiner to take his/her first action.³

² See *User Fees Withheld from the U.S. Patent and Trademark Office (USPTO) 1991-2011*, IP OWNERS ASS’N (June 13, 2011), http://www.ipo.org/AM/Template.cfm?Section=Legislative_Priorities&Template=/CM/ContentDisplay.cfm&ContentID=29295.

³ USPTO, *Performance & Accountability Report: Fiscal Year 2010 12* (2010), available at <http://www.uspto.gov/about/stratplan/ar/2010/USPTOFY2010PAR.pdf>.

The American Bar Association has argued:

Ending the withholding of USPTO fee revenue is about more than just putting an end to the unjust treatment of patent and trademark system users. It is about stopping the erosion of the services available from the USPTO for America's inventors and small and large businesses. Because of the diversion of user fees over the past several years, the time it takes to obtain a patent has begun to rise.⁴

The USPTO has explained that the uncertainty of the annual funding process and the recurring possibility of fee diversion severely restrict its ability to effectively plan for long-term personnel and technology needs, as well as to implement procedures that decrease the likelihood of the issuance of poor-quality patents.⁵

Voicing a similar sentiment, the American Intellectual Property Law Association (AIPLA) argued in its August 13, 2007 letter to then-House Speaker Nancy Pelosi:

The quality and pendency problems confronting the Office, and the subsequent litigation questionable patents can generate, can be directly traced to the siphoning off of USPTO fee revenues from 1992 through 2004 to fund other government operations. Cumulatively, this diversion resulted in a loss of more than \$750 million in fees paid by patent and trademark applicants for the processing of their applications. As a result, the USPTO has been unable to hire, train, and retain the number of skilled examiners needed to cope with the ever increasing number of patent application filings.⁶

In 2004, industry stakeholders generally agreed that they would be willing to pay more in user fees if Congress would pass legislation to permanently end fee diversion. Congress did, indeed, enact a fee increase in the 2005 Consolidated Appropriations Act, but did not act to permanently remedy the fee diversion problem. Again in 2010, industry stakeholders generally agreed to an additional 15 percent increase in USPTO user fees if the fees would be guaranteed to be able to be used by the agency. (This fee increase has been incorporated into recent Senate and House patent reform bills under consideration, but has not been enacted.)

One could reasonably argue that by supporting the implementation of, and increases in, user fees to fund the operations of the USPTO, stakeholders have proven their willingness to use

⁴ ABA SECTION OF IP LAW, *Report to the House of Delegates*, <http://www.abanet.org/intelprop/106legis/ptouserfee.doc>.

⁵ *Patent Reform: The Future of American Innovation: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 110-149 (2007) (statement of Jon W. Dudas, Undersec'y of Commerce for IP and Dir. of the USPTO).

⁶ Michael K. Kirk, *Letter to the Honorable Nancy Pelosi*, AM. IP LAW ASS'N (2007), http://www.aipla.org/Advocacy%20Shared%20Documents/TES_2007-08-13_110C_Pelosi-AdequateFunding-Kirk.pdf.

their own resources to finance intellectual property protections. Such an arrangement represents a desirable public-private partnership model by effectively addressing matters of equal significance to the business community and to our nation: innovation, growth and competitiveness. It is thus important that these fees be used for the purposes intended — both to achieve the goals of innovation, growth, and competitiveness, as well as to encourage future beneficial public-private partnership models.⁷

The effects of recent diversion are easier to discern. From approximately 2005 – 2009, Congress attempted to end the practice of diversion on its own – without legislative mandate – by the enactment of appropriations that provide full funding of the USPTO, in the amounts requested in the president’s budget and equal to projected fee collections. Unfortunately, this congressional self-discipline did not last long. Problems began anew when the USPTO underestimated its fee collections in FY 2010, and, as a result, the appropriations for FY 2010 did not include approximately \$50 million in additional collections. This necessitated the USPTO operating in FY 2011 on a series of short-term continuing resolutions that follow the general rule of restricting agency spending to levels provided in the previous year’s appropriation. In the case of the USPTO, this produced a significantly lower level of spending authority, based on underestimating fee collections for 2010. Also contributing to this storm is that in FY 2011, fee collections, and the corresponding workload of the Office, continue to rise; despite these developments, the Office has no access to those additional funds under the continuing resolution funding mechanism. Thus, for several months during FY 2011, the USPTO was collecting over \$1 million a day that it was not able to put to use.

After Congress passed HR 1473 (Department of Defense and Full-Year Continuing Appropriations Act of 2011), which appropriated to the USPTO about \$100 million less than estimated fee income for the year, PTO Director David Kappos was forced to announce significant spending cuts for the patent examination corps, which have numerous consequences, including:

- A. No overtime;
- B. A hiring freeze;
- C. Training limited to "mandatory training";
- D. Severe Cuts to Patent Cooperation Treaty search funding;
- E. Indefinite postponement of the opening of a Detroit satellite office;
- F. Elimination of all information technology infrastructure investments except for "mission-critical" issues;
- G. Indefinite Postponement of the expedited patent examination program; and
- H. Mandatory reductions in expenses including travel, conferences, and other contracts.⁸

⁷ *Ending Diversion and Ensuring that USPTO Retains its User Fees*, IP OWNERS ASS’N (July 10, 2006), <http://www.ipo.org/AM/Template.cfm?Section=Home&CONTENTID=2709&TEMPLATE=/CM/ContentDisplay.cfm>.

⁸ David Kappos, *An Update on the USPTO's FY 2011 Budget*, DIRECTOR'S FORUM: DAVID KAPPOS' PUBLIC BLOG (Apr. 22, 2011, 9:08 AM), http://www.uspto.gov/blog/director/entry/an_update_on_the_uspto).

In addition to practical problems, the diversion of USPTO user fees also presents a philosophical problem—diversion undermines the pro-technology and pro-innovation rhetoric of our policy makers. Promoting innovation has been an important component of President Obama’s economic plan. Just recently, the President emphasized that the ongoing economic recovery and the nation’s prosperity in the future will depend in large part on this nation’s ability to innovate.⁹ However, imposing a cost on innovators that is not then used to advance the purpose of innovation, is *taxing*, not promoting, innovation. As James Gattuso argued in his 2002 paper entitled “The Invention Tax: PTO and the Diversion of PTO User Fees,” the government should be removing barriers to innovation and technological processes, not creating barriers in the form of a tax:

Should the federal government tax innovation? Although the pro-technology rhetoric of most politicians would imply that such an idea would never fly, such a tax does exist in the form of fees that have been paid by inventors to the U.S. Patent and Trademark Office (PTO) and then diverted to other programs.¹⁰

IV. What is the Solution?

A permanent solution to end USPTO user fee diversion would: cease the injustice of USPTO stakeholders paying to support Federal programs entirely unrelated to the original purpose of the user fee; curtail the wasteful cycle of such stakeholder having to annually lobby the Administration and Congress to stop this inherent tax on innovation; allow the USPTO to engage in the type of long-term planning that will help improve patent quality and shorten patent pendency; and, most importantly in terms of the public’s interest, help promote the innovation that is so critical to our nation’s future economic health. The following are ideas about the various forms such a solution could take.

Idea #1. One such permanent solution would be to reestablish the USPTO as a government corporation. The idea of separate governmental status for the USPTO was raised during the 85th and subsequent Congresses. The National Academy of Public Administration (NAPA) specifically studied the idea of reorganization of the USPTO as a government corporation and recommended corporation status for the USPTO in reports issued in 1985, 1989, and 1995. Ultimately, the opponents who expressed concerns about “corporatizing” the judicial function of granting patent rights—a function which has been historically exercised by government—triumphed, and the USPTO has since remained a Federal agency.¹¹ It is possible that this effort toward privatization or government corporation status could be reinvigorated, but the recent failures of such government sponsored enterprises as Fannie Mae and Freddie Mac would seem to reduce the likely success of such efforts at this time.

⁹ *Obama Lauds Small Business, Innovation*, NATIONAL JOURNAL’S CONGRESS DAILY (Mar. 16, 2009).

¹⁰ James L. Gattuso, *The Invention Tax: PTO and the Diversion of Patent Fees*, Exec. Memorandum No. 842, HERITAGE FOUND. (2002), available at <http://www.heritage.org/research/reports/2002/11/the-invention-tax>.

¹¹ DOROTHY SCHRADER, CONG. RESEARCH SERV., RL 97-591A, PATENT REFORM: OVERVIEW AND COMPARISON OF S. 507 AND H.R. 400 (updated Aug. 4, 1998).

Idea #2. Another solution has been offered year after year by House congressional champions of ending diversion, such as Representatives Conyers, Smith, Berman, Coble, Boucher, Sensenbrenner and Lofgren. The latest iteration was HR 2336, introduced May 6, 2007, with bipartisan support. This bill would have modified provisions relating to the funding of the USPTO to allow the agency to retain and use all fees paid to it. USPTO stakeholders wholeheartedly endorsed this bill. The benefit of this measure was that it would have removed the USPTO from the congressional appropriations cycle. The hurdle to the legislation's passage was that it was not supported by certain key congressional appropriators, since it negated much of their oversight authority and would have decreased the Commerce, Justice, Science and Related Agencies Subcommittee's (hereafter, "CJS Subcommittee" and "CJS bill") appropriations allocation.

To fully understand this opposition, a brief discussion of 302(b) allocations is warranted. Section 302(b) of the 1974 Budget Act creates a system under which a ceiling is created for the total budget authority and outlays available to each Committee for its Subcommittees, and to each Subcommittee for all accounts in its jurisdiction. Since the USPTO is an agency within the Department of Commerce, its appropriation falls under the CJS Subcommittee's Appropriations bill.

Size matters when it comes to 302(b) allocations: the larger the allocation, the more significant the perceived authority of the CJS Chair and the greater the perceived power. Hence, taking a program or account out of a Subcommittee's jurisdiction decreases the Subcommittee's 302(b) allocation and can decrease the perception of power of that subcommittee and of that subcommittee's Chair. Rare is the moment when a Member of Congress willingly relinquishes jurisdiction and/or power — whether such power is real or perceived.

There is a second reason why taking the USPTO out of the congressional appropriations cycle could have a "negative" effect on the CJS Subcommittee's 302(b) allocations. If the amount appropriated to the agency exactly matches the agency's estimated collections, the allocation would not be affected. But estimates are not always exact, and if the CBO re-estimates mid-fiscal year that the USPTO's actual collections exceed its estimated collections, then the CJS Subcommittee has authority over that surplus—authority it will not enthusiastically surrender.

Idea #3. A third solution to the problem of fee diversion floated by sympathetic congressional staff who supported the underlying policy reasons for ending USPTO fee diversion, but who were looking to obviate the procedural hurdles presented by the 302(b) allocations rules was that Congress could create a new, second appropriations account under the USPTO in the CJS bill. If any fees collected are not appropriated to USPTO salaries and expenses, they would automatically be deposited into this second USPTO fund instead of being applied to other federal programs. In addition, the money in this second fund could remain available until expended, so funds would not expire and could carry forward to future years. While this practice would deviate from normal appropriations processes, there is precedent for such an account in the CJS bill — for example, the Counterterrorism Fund.¹² The Counterterrorism Fund was established to have funds readily available to pay for costs incurred

¹² USA PATRIOT Act, Pub. L. No. 107-56, §101.

from a terrorist attack or to support the investigation or prosecution of terrorist activities. The Counterterrorism Fund is neither fee-based nor tied to another account, but does set precedent for holding funds in an account until the Appropriations Committee is notified that they are requested for release for a specific purpose, the same concept as the USPTO fund.

The intent of this third idea was to ensure that all USPTO fees collected are appropriated to the USPTO for the purposes of processing applications and supporting the operations of the agency, while at the same time allowing the CJS Subcommittee to maintain some level of control over the funding process for the USPTO. The idea might be more politically palatable to congressional appropriators than other previously proposed solutions, since it would not trigger 302(b) allocation issues, and the appropriators would retain oversight and control over the agency.

The major limitation of this idea, however, is that it is tied into the annual appropriations cycle, thereby failing one of the major goals of ending fee diversion — giving the USPTO the ability to engage in stable, long-term planning. Moreover, there is the danger that since USPTO's access to this second fund is tied to the appropriator's release of the money, the user fees could be held hostage and not released to the agency. It is because of these significant drawbacks that this solution is not one that is likely to be promoted by USPTO stakeholders.

Idea #4. Another solution involves refunds. During the 108th Congress, this strategy was employed to attempt to end fee diversion. Section 5 of HR 1561 required the Director of the USPTO to refund fees paid by those seeking services from the agency that are in excess of the amounts appropriated for the agency each year. The USPTO Director would determine by regulation which applicants would receive payments and the amounts of the payments. This strategy was colloquially referred to as the “refund system.” This bill was supported by the USPTO, passed the House 379 to 28, and was reported out of the Senate Judiciary Committee. The major drawback, voiced by many USPTO stakeholders who supported the intent of the legislation, was that the refund process would be costly and unwieldy. It is possible that this strategy could pose modest 302(b) issues as well. According to a CBO letter regarding the amendment to HR 1561 that called for the “refund system,” “[t]he amendment by itself would not affect Federal spending, but in conjunction with the rest of the bill and future appropriations action, it could result in additional Federal outlays.”¹³ The concern that refunds provided in years subsequent to collections could cause scoring problems was echoed by certain Senate Appropriators in a May 4, 2004 letter to the Senate Majority Leader.¹⁴

Idea #5. A fifth solution to end fee diversion was embodied in the COMPETE Act, S 1020, during the 109th Congress. It used what was referred to as a “fee reduction system.” This solution would have allowed the USPTO Director to adjust the fees downward in a subsequent year if estimated fee collections by the USPTO exceeded the amount appropriated for that fiscal year. The benefit of this proposal is that it essentially ended fee diversion and the unfair tax on innovators, and the 302(b) problems, if any, would likely be modest. The drawbacks are that there is a disconnect between the “excess” charge to one year's applicants and the fee reduction

¹³ CBO, Letter to Rep. Sensenbrenner, Jr. (Mar. 3, 2004).

¹⁴ Letter from Sens. Stevens, Byrd, Gregg and Hollings, to Sen. Frist (May 4, 2004).

granted to the next year's applicants. Moreover, since this solution is based on estimated collections as opposed to actual dollars collected, there is always a chance that the estimate could be wrong. Finally, like the "refund system," there is the risk that congressional appropriators could "starve" the agency by appropriating less money than the agency needs to function efficiently. In years past, the USPTO seemed to prefer the rebate solution embodied in HR 1561 over the fee reduction solution in S 1020, despite its greater logistical difficulty.

Idea #6. Arguably, the best solution to date is incorporated in this Congress's patent reform bills: "The America Invents Act," S.23, which passed the Senate March 8, 2011 by a vote of 95-5, and H.R. 1249, which was recently reported out of the House Judiciary Committee by a vote of 32-3 on April 14, 2011.

This solution (the original version of which first appeared in the Patent Reform Act of 2007, S. 1145) would permanently secure funding for the USPTO by creating a new revolving fund in the Treasury designated solely for the agency's use. The new revolving fund would allow the USPTO to retain all the user fees it collects without relying on annual appropriations. Thus, Congress and the Administration would be prevented from using USPTO user fees for other, unrelated general revenue purposes, as has repeatedly occurred in the past. This legislative provision also includes extensive annual reporting, notification and independent auditing requirements to assure fiscal discipline, responsibility and accountability by USPTO. Such language would achieve the goal of permanently ending the diversion of USPTO user fees, while at the same time preserving the jurisdiction and prerogatives of the Judiciary and Appropriations Committees, which is politically prudent.

If, during this Congress, this solution, which has already been strongly backed by the Senate and the House Judiciary Committee, is embraced by the full House, then we may finally have a permanent end to fee diversion so the PTO can effectively and efficiently budget for its future operational needs.

Unfortunately, while this solution has enjoyed bi-partisan support thus far this Congress, a new development threatens its passage and has injected a partisan tone into the debate. On June 6, 2011, House Appropriations Chairman Harold Rogers and House Budget Chairman Paul Ryan sent a letter to House Judiciary Chairman Lamar Smith opposing the bill, saying that "[p]lacing PTO spending on mandatory auto-pilot as outlined in H.R. 1249 would also hand the Congressional 'power of the purse' – bestowed in the Constitution – to the Obama White House . . ."¹⁵

It was Republican leaders who fired back, however. The following day, June 7, 2011, House Judiciary Chairman Lamar Smith responded that contrary to putting the USPTO on auto-pilot, H.R. 1249 would actually promote accountability and transparency, creating more channels for oversight than currently exist.¹⁶ Two days later, fiscal conservative Senator Tom Coburn penned a letter arguing that "[w]e cannot have true patent reform without ending fee diversion

¹⁵ Letter from Reps. Paul Ryan & Harold Rogers to Rep. Lamar Smith, Chairman of H. Judiciary Committee (June 6, 2011).

¹⁶ Letter from Rep. Lamar Smith, Chairman of H. Judiciary Comm., to Reps. Paul Ryan & Harold Rogers, (June 7, 2011).

and providing the PTO with a permanent, consistent source of funding” and that the “power of the purse does not provide Congress authority of non-taxpayer funds.”¹⁷

V. Conclusion

Now is the time to permanently end the tax on innovation and the unjust, unwise diversion of USPTO user fees. Statements of Senate Judiciary Committee leaders summarize the justification most eloquently. As argued by Chairman Senator Patrick Leahy, “If we are to maintain our position at the forefront of the world’s economy and continue to lead the globe in innovation and production, then we must have an efficient and streamlined patent system to allow for high quality patents that limits counterproductive litigation.”¹⁸

Similarly, Senator Orrin Hatch has emphasized:

The patent system is the bedrock of innovation, especially in today’s global economy...America’s ingenuity continues to fund our economy, and we must protect new ideas and investments in innovation and creativity. Patents encourage technological advancement by providing incentives to invent, invest in, and disclose new technology. Now, more than ever, it is important to ensure efficiency and increased quality in the issuance of patents.¹⁹

The support comes not only from the legislative branch. The President’s FY 2012 Budget supports a sustainable funding model for the PTO. It states, “another immediate priority is to implement a sustainable funding model that will allow the agency to manage fluctuations in filings and revenues while sustaining operations on a multi-year basis. A sustainable funding model includes: (1) ensuring access to fee collections to support the agency’s objectives”

President Obama’s economic adviser, Austan Goolsbee, said, “Funds have been diverted away from the Patent Office itself to other things. We have got to let the Patent Office keep its own revenues so they can address the needs that American inventors and businesses have so they can grow jobs here in this country.”²⁰

USPTO fee diversion must stop, and must be stopped now, to ensure that the USPTO can engage in the stable, long-term planning necessary for the issuance of timely, high-quality patents. The best legislative solutions will necessitate congressional appropriators prioritizing U.S. innovation, jobs and the economy over “inside the Beltway” politics. But good policies often come with painful politics. If Congress can handle a little pain in the short term, the nation will likely be rewarded with a more efficient USPTO and national prosperity over the long term.

¹⁷ Letter from Sen. Tom Coburn to Reps. Paul Ryan & Harold Rogers, (June 9, 2011).

¹⁸ Press Release, Office of Sen. Patrick Leahy: Leahy, Hatch, Berman and Smith Introduce Bicameral, Bipartisan Patent Reform Legislation (Apr. 18, 2007), available at <http://leahy.senate.gov/press/200704/041807a.html>.

¹⁹ *Id.*

²⁰ Austan Goolsbee, *White Board: Austan Goolsbee on Patent Reform*, THE WHITE HOUSE BLOG (Mar. 7, 2011, 5:00 AM), <http://www.whitehouse.gov/blog/2011/03/07/white-board-austan-goolsbee-patent-reform> (from embedded video).