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ISSUE BRIEF

Diversion of USPTO User Fees: A Tax on Innovation

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Synopsis: With the extraordinary turbulence of the global markets, the Obama Administration's emphasis on stimulating the U.S. economy and creating U.S. jobs, and the increasing recognition from congressional appropriators that a strong patent system is critical to an innovation-friendly government, it is more important than ever that Congress pass a permanent legislative solution to the damaging practice of taxing innovation by diverting user fees away from the U.S. Patent and Trademark Office (USPTO).

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 "To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."

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 exploit the invention itself. The patent is issued by the 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, than in earlier periods when our natural resources and organization of production were our primary advantages.

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. Before 1990, taxpayers supported the operations of the USPTO. Such support was eliminated in 1990 with the passage of the Omnibus Reconciliation At 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 request of the Congressional Appropriations Committees that the agency be allowed to use the revenues in the account. These fees paid by users of the patent and trademark systems are referred to as "USPTO user fees."

What is Meant by "Diversion" of USPTO User Fees?

This 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 August 2005 Report by a Panel of the National Academy of Public Administration (NAPA), USPTO fee diversion totaled $741 million in fiscal years 1992-2004.[2]

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").

In March 2008, the backlog of unexamined applications was approximately 760,000.[3]

The American Bar Association has argued that:

> 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 House Speaker Nancy Pelosi that:

> The quality and pendency problems confronting the Office, and the subsequent litigation questionable patents can generate, can be di-

rectly 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 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.

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 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 competiveness, as well as to encourage future beneficial public-private partnership models.[7]

The diversion of USPTO user fees also presents a philosophical problem that 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.[8] Imposing a cost on innovators, however, which 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.[9]

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 well-being.

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.[10] 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.

Another solution has been offered year after year by House congressional champions of ending diversion, such as Reps. Conyers, Smith, Berman, Coble, Boucher, Sensenbrenner and Lofgren. The latest example 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 decrease 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. It is rare when a Member of Congress will willingly relinquish 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.

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 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. The Counterterrorism Fund was established to have funds readily available to pay for costs incurred 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 maintain 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.

During the 108th Congress, another strategy was introduced 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", "The 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."[11] 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.[12]

A fifth strategy 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 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 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.

A sixth solution, and arguably the best solution to date, is a variation of an amendment to The Patent Reform Act of 2007, S 1145, legislation sponsored by Senators Leahy and Hatch. The original amendment would have permanently secured 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 have allowed the USPTO to retain all the user fees it collects without relying on annual appropriations. Thus, Congress and the Administration would have been prevented from using USPTO user fees for other, unrelated general revenue purposes as has repeatedly occurred in the past. This legislative proposal 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 Appropriations Committees, which would be politically prudent. This amendment, which was offered by Senator Coburn, passed the Senate Judiciary Committee by voice vote on July 19, 2007. The underlying patent reform bill never passed the Senate, however, so the amendment died along with the rest of the bill. The substance of the amendment was included in another patent reform bill, the Patent Reform Act of 2008, S 3600, sponsored by Senator Kyl, but that vehicle died along with S 1145 when Congress adjourned.

This legislative solution to the USPTO user fee diversion problem enjoyed bipartisan and bicameral support. It was accepted by voice vote by the Senate Judiciary Committee; it claimed the support of some of the patent reform bill's staunchest critics; and it was supported by leading Democrats in the House.[13]

One of the biggest obstacles to the original amendment that was offered, in addition to the same 302(b) allocation issues discussed above, is its scoring. The Congressional Budget Office estimated that S 1145, which included this solution to end fee diversion, would increase direct spending over the 2009-2018 period.

> Much of that change would result from making permanent [US]PTO's authority to collect and spend certain fees, thus shifting the collections and spending out of [US]PTO's appropriation account. In total, those changes would increase budget deficits (or decrease surpluses) by $1.4 billion over the 2009-2018 period.[14]

A simple change to the amendment, however, creates a seventh possible solution that could obviate the scoring problem. CBO had interpreted the original amendment to mean that the USPTO could now have access to the user fees that had previously been diverted. If the amendment is changed to apply only prospectively, however, this should eliminate most if not all of the scoring problems.

A "302(f) Budget Point of Order," however, would still exist against any provision creating a new revolving fund for the technical reason that this solution would make the spending of USPTO user fees

at the discretion of the USPTO Director, not at the discretion of Congress through the annual appropriations process. So any time spending authority is removed from the appropriations committee, a Budget Point of Order results.

A Budget Point of Order is a legislative mechanism that prohibits congressional actions and consideration of legislation. Congress may, however, waive a Budget Point of Order. In the House, Budget Points of Order usually are waived by a "special rule" reported by the Rules Committee and adopted by the full House. In the Senate, a waiver motion may be adopted to waive budget rules. Most Budget Act waiver motions require a three-fifths vote of Senators. In addition, this Budget Points of Order may be waived by unanimous consent in the House or Senate or by suspension of the rules in the House.

If, during the 111th Congress, this seventh solution is strongly backed by Senate Judiciary Committee leaders who sit on both the Judiciary Committees as well as the Appropriations Committees, then it is very possible that the leaders of the Senate CJS Appropriations Subcommittee could be convinced to either support or simply to not oppose the measure or that the three-fifths of the vote of the Senators could be obtained to overcome resistance from other congressional appropriators. In the House, Judiciary Leadership would have to engage the support of the overall House Leadership to overcome any obstacles posed by House Appropriators.

Is a Permanent Solution Necessary?

Is a permanent solution necessary since the government has not been diverting as much money away from the USPTO in recent years as it has in the past? In recent years, the Administration and Congress have shown restraint with regard to diverting user fees away from the USPTO. In fact, since Fiscal Year 2005, the President's budget recommended full access to collected fees, and Congress has followed suit.

Both the Administration and Congress have cited their recent restraint in arguing that no permanent solution is needed to address the diversion of USPTO user fees. For instance, in a July 11, 2007 letter from Senators Byrd and Mikulski stated that:

> We support the goal of the proposed provisions (which would take the PTO off budget) – to ensure that fees paid by inventors are used solely for [US]PTO operations. We acknowledge the validity of concerns about the past practice of 'diverting' [US]PTO user fees to pay for other government programs…..However, the provisions are unnecessary. Since Fiscal Year 2005, the Appropriations Committee has rejected the practice of diverting USPTO user fees for other purposes, and instead has consistently recommended that PTO retain every dollar it collects. (When this letter was written, Senator Byrd was Chair of the full Senate Appropriations Committee and Senator Mikulski was Chair of the CJS Subcommittee.)[15]

These sentiments are echoed by a letter written by Senators Inouye, Mikulski, Cochran and Shelby dated March 25, 2009, wherein the authors state:

> Our Nation's future competitiveness depends on an efficient patent system, and we support the goal of ensuring that PTO fees pay only for PTO operations. However, we believe that the approach adopted by the Appropriations Committee is the most effective way of providing the greatest possible oversight of taxpayer dollars.

There is no doubt that the Administration and Congress have kept fee diversion in check for the past few years. But such recent restraint does not guard against future diversion.

The American Intellectual Property Law Association (AIPLA) argued in its August 13, 2007 letter to House Speaker Nancy Pelosi (D-CA) that:

> While the Congress and the Administration have permitted the Office to retain essentially all of its user fees for the last three fiscal years, there is nothing to prevent the devastating practice of fee diversion from returning. The beginning steps taken by the Office to address its quality and pendency issues—made possible by allowing it to receive and use all of its fee revenues— demonstrate the absolute necessity of allowing the Office to continue to retain and use its fee revenues. While everyone wishes for a more rapid recovery by the Office, it must be remembered that the current situation is the result of a twelve-year starvation funding diet. It will take permanent, continued full funding of the USPTO—as guaranteed by the amendment to S 1145—to overcome these challenges. The Office must have a guarantee of such funding in order to intelligently plan for and meet the

> multitude of challenges facing the Office, and its users who pay the fees deserve no less.[16]

Jon Dudas, Director of the USPTO from 2004-2009, said it succinctly in his testimony before the Senate Judiciary Committee on June 6, 2007:

> Full access to user fees allows the USPTO to continue our successful model of disciplined focus on real measures that enhance quality and increase production, increase hiring and training, promote electronic filing and processing, provide telework opportunities for our employees and improve intellectual property protection and enforcement domestically and abroad.[17]

The recent restraint demonstrated by Congress in not diverting user fees away from the USPTO is very likely a direct result of the outrage expressed by USPTO stakeholders about past diversion. Requiring the USPTO user community to return to Congress year after year to request that the user fees they pay not be diverted is certainly no long-term solution. Moreover, such a system is antithetical to promoting future desirable public-private partnerships.

Indeed, one could reasonably argue that it is more pressing now than ever to pass a permanent legislative solution to the USPTO fee diversion problem. The current economic downturn has already put pressure on other revenues that fuel the Treasury. It may be harder for congressional appropriators, who have used restraint in recent years, to resist using USPTO user fees to provide for other worthwhile, yet unrelated Federal programs.

Finally, Congress has spent considerable time and resources addressing the possibility of broad patent reform in the 109th and 110th Congress, tackling such issues as reform of damages, the inequitable conduct doctrine, a possible post-grant proceeding at the USPTO, reform of the best mode doctrine, and other significant changes to the patent system. It is fundamental to any meaningful patent reform, however, that the USPTO be able to rely on a permanent and stable source of funding.

Witness after witness testifying before Congress about broader patent reform insisted on the need to permanently end USPTO fee diversion. Then-IPO President Jeffrey Hawley testified before the Senate Judiciary Committee with regard to the patent reform issues of injunctions and damages saying:

> The diversion of more than three-quarters of a billion dollars in USPTO user fees since 1992 has been a major factor in the PTO crisis. If the PTO had had the opportunity to spend the diverted funds, which were paid by our members and other PTO users for services they expected to receive, today's picture would be very different.[18]

Essentially, tackling broader reforms to the patent system without permanently fixing diversion of USPTO user fees would be like restructuring a dam system without plugging the leaking holes; it just doesn't make any sense.

Conclusion

Now is the time to permanently end the tax on innovations and the unjust, unwise diversion of USPTO user fees. Statements of the 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."[19]

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.[20f]

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 the short-term pain, the nation will likely be rewarded with a more efficient USPTO and longer-term national prosperity.

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