UNITED STATES DEPARTMENT OF COMMERCE
National Bureau of Standards
Washington, D.C. 20234
OFFICE OF THE DIRECTOR

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MEMORANDUM FOR Robert B. Ellert
Assistant General Counsel
for Science and Technology

From: Ernest Ambler
Director

Subject: Small Business Nonprofit Organization Patent Procedures Act

This is in response to the request of the Assistant General Counsel for Legislation that the National Bureau of Standards furnish its comments to the Assistant Secretary for Science and Technology, on S.3496, a bill

> "To amend Title 35 of the U.S. Code: to establish a uniform Federal patent procedure for small businesses and nonprofit organizations; to create a consistent policy and procedure concerning patentability of inventions made with Federal assistance; and for other related purposes."

As indicated by its title, this bill represents an effort to allow small businesses and nonprofit organizations to obtain patent rights in technology resulting from government-funded research and development contracts. The bill would establish a uniform patent policy for all agencies of the Federal government by permitting universities and other nonprofit organizations and small businesses to take title to inventions which are conceived or first actually reduced to practice in the performance of work under a funding agreement. Rights reserved to the Federal government under any invention which may be made include an irrevocable, nonexclusive and paid-up license together with controls available to the funding agency requiring the licensing of such inventions in cases where the technology represented by the invention is not being effectively transferred to work for the public good.

The bill also provides for the licensing of patents by small businesses and nonprofit organizations in those cases where they elect to retain title to an invention. In this respect, a key feature in the bill permits payment to the Federal agency of royalties if an invention reaches a certain level of success as well as a percentage from sales in excess of a predetermined amount where the product sold embodies the invention or is manufactured by a process employing the invention. Patent licensing by Federal agencies as to Federally owned patents, either in the United States or in foreign countries, is also a feature of the bill.

The objectives of this bill are commendable. It is directed toward establishing a uniform Federal policy for nonprofit organizations and small businesses on patentable technology resulting from Federally sponsored research and development. The bill, which expired without action by the Senate upon the adjournment of the 95th Congress, is similar in certain respects to H.R. 6249, a bill introduced last year but which also did not become law. H.R. 6249 would permit a contractor to the Federal government to retain title to those inventions in which the contractor filed a U.S. patent application and declared its intent to achieve practical application of the invention; it is not, therefore, limited to universities, small businesses, and nonprofit organizations as is S.3496. Unlike S.3496, H.R. 6249 has no cost recovery provisions for returning R&D costs from the beneficiaries of Federal R&D funding. S.3496 and H.R. 6249 are, however, similar in several other respects. Sections 210, 211 and 213 of S.3496, except for minor differences, are virtually identical to sections 401, 402 and 404, respectively, of H.R. 6249. Also, section 211 of S.3496, except for the preference recited for small business firms, is essentially the same as section 403 of H.R. 6249.

In the following paragraphs, a brief summary of the major provisions of S.3496 will precede specific comments and recommendations which reflect the views of the National Bureau of Standards.

Section 202 provides that each small business firm and nonprofit organization (defined as universities and other institutions of higher education and certain organizations exempted from taxation under the Internal Revenue Code) shall have a reasonable time to elect to retain title to inventions. It is noted that in 1976, Dr. Ancker-Johnson forwarded to OMB for official clearance a draft bill entitled "Federal Intellectual Property Policy Act of 1976." The draft bill was a product of the then Committee on Government Patent Policy (CGPP) and it contained a provision (section 312(c)) which similarly allowed title retention. H.R. 6249 contains an equally identical provision (section 314) but one which is broadly applicable to "any contract, grant, or agreement entered into between any Federal agency and any person for the performance of . . . work substantially funded by the Federal Government." If it can be assumed that the Department of Commerce still supports in principle a view which it expressed under the prior administration in the CGPP draft bill, it would seem inappropriate to object to S.3496 which is more protective of the public interest in that it reduces the classes of funded programs under which title may be retained to R&D sponsored inventions.

Another provision of the bill, binding on nonprofit organizations only (section 202(c)(7)), prohibits such organizations from assigning patent rights without the approval of the Federal agency, prohibits granting exclusive licenses for a period in excess of the earlier of 5 years from

the date of first commercial use or sale of the invention or 8 years from the date of the exclusive license, and provides that all proceeds, once administration expenses are considered, be used to support scientific research or education. Other provisions provide for "march-in" rights if an invention is not being exploited (section 203), specify that no foreign-owned or controlled firm is eligible to receive patent rights, except when the restriction is waived by the funding Federal agency (section 205), permit exclusive licensing of Government-owned patents (sections 210, 213), provide licensing preferences to small business firms (section 211), and authorize the Secretary of Commerce to coordinate the licensing practices of Federal agencies (section 212). With respect to subsection 210(7) of the bill, Federal agencies are authorized to transfer custody and administration to the Department of Commerce of Federally owned patents. It is understood that NTIS currently has in effect a number of agreements with other Federal agencies for promoting the technology transfer of inventions under Department Organization Order 30-7A, dated April 9, 1976, as amended.

As was mentioned earlier, a key feature of the bill (section 204) calls for payments to the Government if an invention is successfully licensed or marketed. Thus, if a patent holder receives $250,000 in after-tax profits from licensing any such invention during a 10-year period, or receives after-tax profits in excess of $2,000,000 on sales of products embodying the invention or manufactured by a process employing the invention within a 10-year period, the Government, in the case of licensing (section 204(a)), is entitled to collect a percentage, up to 50 percent, of all net income above $250,000. In the case of sales (section 204(b)), the Government may negotiate a share of all additional income accruing from such sales. In neither case may the amounts received by the Government exceed the amount the Federal agency expended in funding the agreement under which the invention was made.

In several administrative provisions of the bill, the General Services Administration will regulate the licensing of Federally owned inventions (section 211), and the Office of Federal Procurement Policy, relying on recommendations of the Office of Science and Technology Policy, may establish standard funding agreement provisions which may be applicable to Federal agencies (section 209). Lastly, the bill amends or repeals parts of all Acts covering similar subject matter (section 214), and establishes the effective date of the Act (section 215).

The purpose of section 204 is entirely clear--if a commercial product results from an R&D contract which produces an invention either licensed or in some way incorporated in a commercial item, the Government stands to recover a portion of its R&D expenses either as royalties or income occurring from sales when the product is licensed or sold profitably. In this connection, we note past studies made within the Department of Commerce which apparently favor a policy of recouping a share of Federal investment in nonrecurring costs. A few examples of internal documentation

which reflect such a preference include a memorandum dated September 16, 1974, from the then Deputy General Counsel Bernard V. Parrette, Department of Commerce, to Mr. Leon Ullman, Deputy Assistant Attorney General, Department of Justice, and a memorandum dated September 24, 1974, from Kenneth R. Clark of the DoC General Counsel's Office to Mr. Ullman addressing the same topic and presenting an analysis of several alternatives for appropriate recoupment of Government costs. Although we have not studied Mr. Clark's memorandum at length, it appears that the program represented by Tab B of his analysis corresponds to a large degree to the recoupment program set forth in section 204 of the bill, recoupment on licensing and sales being two common elements.

More recent developments which reflect a continuing Federal concern on developing general guidelines for R&D recoupment are contained in a June 29, 1976, memorandum from H. Guyford Stever, former Director of the Office of Science and Technology Policy, to agency representatives participating in a study of recoupment generated by a memorandum decision Number 23 issued August 2, 1974, by the Council on International Economic Policy. Recoupment guidelines attached to Dr. Stever's memorandum reveal quantifiable support for a policy for recoupment on sales outside the Federal Government, whether foreign or domestic. Such executive agency momentum to achieve a uniform policy in favor of R&D recoupment, and section 204 of the bill itself, are, we note, in disagreement with the 1972 report of the Committee on Government Procurement (COGP) whose Recommendation B-9 was against recovering R&D costs from Government contractors and grantees except under unusual circumstances approved by the agency head. One factor cited by the COGP in support of Recommendation B-9 was that commercial products are likely to result from Federal R&D programs only infrequently and that such a program does not offer sufficient potential cost recovery to warrant its broad application.

It is reiterated that a grantee institution, under the provisions of the bill, can elect to retain title to any subject invention and simply file patent applications toward achieving practical application of the invention. This procedure is similar to that established by regulations implementing the Institutional Patent Agreement (43 FR 4424, February 2, 1978) which were promulgated by the General Services Administration. If it is assumed that the bill is ultimately enacted, the legislative relief it offers to those universities and other institutions of higher learning seeking to have a freer hand in granting exclusive rights to R&D generated inventions would, in our view, supersede the GSA Institutional Patent Agreement regulations. It is also reasonable to assume that enactment of the bill in its present form would still recent congressional criticism of permitting universities and other nonprofit organizations to retain ownership of their discoveries on the basis of the present GSA regulations.

In the final paragraphs, we offer comment on several minor points.

In section 201(c) the term "subject inventor" is to our knowledge without parallel in any U.S. patent statute or regulation. Indeed, in addition to the definition being entirely contradictory in terms, and

being in disagreement with the wording of the Constitutional Provision, Art. 1, sec. 8, its use would seem in conflict with specific provisions of Title 35, United States Code, particularly sections 111, 116 and 118, thereof. The confusion introduced by the term "subject inventor" is no more apparent than when reading sections 202(c)(7)(c), 202(c)(8) and sections 206(iii) and (iv) of the bill. We suggest that section 201(c) be deleted in its entirety and appropriate modification be made throughout the bill in each case where the term "subject inventor" occurs. Placing any reporting requirements upon the nongovernment contractor or grantee, after the manner prescribed in 41 CFR Part 1-9, would appear to offer a reasonable alternative to the use of the term objected to.

Section 204 seems unwisely arranged in the words employed. For example, subsections (a) and (b) differ as to the recipient of recoupment funds, the United States being designated in the first subsection and the Government being named in the second subsection. In subsection 204(b), could not the period commence with the first sale rather than with "commercial exploitation" as the latter term is susceptible to various interpretations. Further, as to section 204(b), we would propose a closer examination or even a definition of the term "income" as it is somewhat unclear from the bill's provision what the base is to be when negotiating recoupment proceeds based upon sales. In this same section, as a final comment, we are doubtful that the "Federal funding" mentioned in subsection (a) is intended to be different from the "Government funding" recited in subsection (b).

In summary, S.3496 appears to provide an answer to the complaint common to universities and institutions of higher education that the lack of uniformity in applying Federal patent rights clauses obstructs the flow of research accomplishments into the stream of technology utilization. As a substitute for the GSA regulations governing Institutional Patent Agreements, S.3496 would furnish a statutory basis for regulations permitting title to remain with such institutions. The provisions of the bill under which Federal R&D costs can be recovered up to the level of Federal input may operate to satisfy any who contend that valuable property rights would be given away. The bill, moreover, appears to provide adequate controls over indiscriminate assignment or licensing activities harmful to domestic corporations or concerns, while reserving to small businesses and nonprofit organizations the latitude necessary to conduct a financially effective technology transfer program for the public benefit. If the changes suggested herein could be incorporated in the bill, we would be pleased to support it.

Copies of each of the documents referred to above will be made available at your request.