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BEFORE THE SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES,

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COMMITTEE ON THE JUDICIARY

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Mr. Chairman and Members of the Subcommittee:

I come before you at a time when our nation is under grave economic stress. We confront a troubled world in which our economic strength is an indispensable part of our nation's security. President Carter has directed the Department of Commerce to promote our non-agricultural trade and to fashion new programs and policies to stimulate greater productivity and innovation in industry. Our mission, therefore, is both immediate and long-term. We seek to encourage development of American products of such quality and price that they are competitive both abroad and at home.

The underlying problem has been long in the making. It will not be solved overnight. Indicators of the problem are a decline in our productivity growth; a decline in our research and development; a drop in the share of U.S. patents awarded to Americans; and a decline in our investments in new processes and products. These declines are generally acknowledged by the business and labor leadership of our nation and are recognized by the public at large.

Last October, President Carter, in his Message to the Congress, said, "Industrial innovation -- the development and commercialization of new products and processes -- is an essential element of a strong and growing American economy. It helps ensure economic vitality, improved productivity, international competitiveness, job creation, and an improved quality of life for every American." In this message, the President took an important and bold first step to challenge the declines that have afflicted our business and industrial sector. A cardinal principle in the President's program is improvement of the United States patent system and federal patent policy.

Patents have a vital role to play in promoting industrial innovation. The progress of an invention from idea to commercial product or process usually is long and expensive. Patent rights encourage entrepreneurs to invest risk capital to develop an invention knowing that successful efforts will be rewarded before competitors are free to copy cheaply what has been created with such difficulty.

I appreciate this opportunity to appear before you today to discuss two Administration bills relating to the United States patent system that are pending before your subcommittee. The first is H.R. 6933, the omnibus legislation to provide a system for the reexamination of issued patents, a new fee system for the Patent and Trademark Office (PTO), and a uniform government

policy for the allocation of rights in federally-financed contractor inventions, which I transmitted to the Congress on behalf of the Administration and which was introduced by Chairman Kastenmeier for himself, Chairman Rodino and Congressman Railsback. The second is H.R. 3806, Administration legislation to establish a Court of Appeals for the Federal Circuit to hear such things as patent-related federal cases, which was introduced by Chairman Rodino .

I am accompanied today by Dr. Jordan J. Baruch, the Assistant Secretary of Commerce for Productivity, Technology, and Innovation, and by Mr. Sidney Diamond, the Commissioner of Patents and Trademarks. They are prepared to join me in responding to any questions you might have.

H.R. 6933 and H.R. 3806 will accomplish important independent objectives. Together, they are directed at strengthening the industrial innovation process in order to improve our nation's economic health. These bills are indispensible to the program of the Department of Commerce.

Government Patent Policy

The Administration's omnibus bill, H.R. 6933, would establish a uniform, two-tier policy for the commercialization and allocation of rights in patentable inventions resulting from federally-sponsored or supported research and development. I respectfully request that the Statement of

Purpose of Need and Section-by-Section Analysis which accompanied the bill when I transmitted it to Congress be placed in the record.

The bill provides for the allocation of rights in contractor inventions and in inventions made by federal employees. It also provides for the licensing of federally-owned inventions. There has been some difference of opinion about the policy of giving title to small businesses and nonprofit organizations and of giving other contractors exclusive licenses in whatever fields of use they specify and agree to commercialize.

There is little evidence of which I am aware to support the notion that patent policy has had any adverse impact on market structure. The Antitrust Division of the Department of Justice thoroughly reconsidered its historical position on the patent policy question in connection with the Domestic Policy Review of Industrial Innovation. It concluded, prior to the President's decision, that no significant anticompetitive consequences would result from adoption of a patent policy of the kind embodied in H.R. 6933 because of the safeguards which it contains. Deputy Assistant Attorney General Ky Ewing, who has much greater knowledge in this area than I possess, will discuss this subject with you.

The notion that the government should own contractor inventions and simply dedicate them to the public at large rests on a fallacy. It is true that the fact of public support gives rise to an important public interest in the development and use of these inventions. Observation shows, however, that this public interest is not served by a public dedication policy.

The costs and risks of commercializing an invention ordinarily are so substantial that it will not take place, or even be attempted, in the absence of exclusive rights. Government ownership of inventions with the offer of unrestricted public use has resulted in an exceptionally low rate of commercial development of federally-financed inventions. Unless the government decides to engage in the business of commercializing patents in competition with private companies, most contractor patents will not be commercialized under a policy of dedication to the public.

Nonetheless, the fact of public support at the inventive stage of the innovation process does give rise to a strong and continuing public interest in what happens to the invention. H.R. 6933 protects this interest by entitling the government to recover exclusive commercial rights from contractors:

(1) if a contractor fails to achieve practical application of an invention;

(2) if necessary to protect the national security;

(3) if necessary to meet requirements for public use specified by federal regulation;

(4) as a remedy for a contractor's violation of the antitrust laws; or

(5) if a contractor fails to comply with the bill's reporting requirements.

H.R. 6933 seeks to maximize the commercialization of federally-financed inventions. We aim to maximize the direct benefit to the public by making more inventions available and to maximize the indirect benefit to the public by making our economy strong and our industry more advanced and more competitive internationally.

The bill gives title to small businesses and to nonprofit organizations "in recognition," as the President said, "of their special place in our society." The adaptability of small businesses has been a particularly important source of major innovations and of new jobs. Moreover, small businesses have a particularly strong incentive to promote the commercialization of their inventions in multiple fields of use.

The government would retain the right to license inventions not selected by small businesses or nonprofit organization and fields of use not selected by other contractors. The government, and particularly the Department of Commerce, will

engage in a vigorous program of evaluating the commercial potential of government-owned rights across a wide range of industries and of actively seeking to license commercially attractive patent rights.

As I have indicated, the public interest is advanced by maximizing the commercialization of federally-financed inventions. The government program will add to the commercialization of an invention achieved by the contractor whatever commercialization we can achieve ourselves through an invigorated licensing policy.

The public interest is protected both by the government rights to which I already have referred and by the so-called "second look" provision . Although larger contractors will know at the time of contracting that they ordinarily will be able to receive an exclusive license under any forthcoming invention in their specified fields of use, they will not actually receive the license until after the invention has been identified, their intention to commercialize has been announced, and their selection of fields of use has been submitted to the contracting agency.

After the contractor has submitted this information to the agency, the agency has ninety days in which it may determine whether the contractor's acquisition of an exclusive license in any selected field of use would be contrary to the requirements

of the agency's mission, the national security, or the antitrust laws. The contractor's expectations of receiving exclusive commercial rights in an invention are increased by limiting the scope of the agency's possible inquiry underlying this determination to those unforeseen circumstances which have become apparent since the time of contracting that require it to deny the contractor exclusive commercial rights with respect to a particular field of use.

In sum, I believe that H.R. 6933 protects the public against the evils feared by advocates of public dedication of federally-financed inventions at the same time that it achieves the objectives of maximizing the commercialization of those inventions and promoting contractor participation in federal research and development work of concern to the mission agencies and the advocates of contractor title.

Patent Reexamination

The controversy over the allocation of patent rights to federally-financed inventions illustrates my earlier statement that patents play an important role in the industrial innovation process. Patents are awarded in exchange for the public disclosure of an invention and its uses. At the same time that they add to our store of usable knowledge, the limited exclusive commercial rights they provide can stimulate a firm to make the often risky investment that is required to

bring an invention to market. Doubt about the validity of an issued patent creates the threat of litigation with its inevitable delays and uncertain outcome. This dilutes the strength of the patent incentive and places special hardships on small businesses and individual inventors -- those least able to finance and await the outcome of litigation.

A fundamental cause of the uncertainty about a patent's enforceability is that pertinent prior patents or printed publications often are only discovered after a patent has issued and become commercially important. While we are engaged in an ongoing effort to upgrade the quality of the Patent and Trademark Office, it is inevitable that, once a patent becomes commercially important, those financially interested in proving it invalid may be able to devote vastly more resources to attacking it than the government would ever spend on its initial examination.

In his October Innovation Message, the President proposed a system for the reexamination of a patent by the PTO at any party's request. H.R. 6933 provides for such reexamination if the requesting party persuades the Commissioner of Patent and Trademarks that a substantial new question of patentability exists. The requesting party must pay the full cost to the PTO of reexamination. Since courts generally give great credence to the PTO's judgment with respect to information actually cited by or to the PTO in the course of an examination, we

expect this comparatively inexpensive and speedy proceeding to displace substantially more expensive and time consuming litigation.

The New PTO Fee System

At present, most patent and trademark fees are fixed by statute. Congress last enacted fee legislation in 1965, raising from 29 percent to 67 percent the percentage of the PTO's then operating costs recovered by fees. Since that date fees have remained unchanged and, as of fiscal year 1979, the recovered percentage has declined to 27 percent.

H.R. 6933 establishes a mechanism for the administrative setting of all patent and trademark fees. Fees are to recover 60 percent of the costs of patent application processing and 100 percent of the costs of all other patent and trademark services. Fees may be administratively adjusted to ensure obtaining these recovery rates. Revenues from fees would be credited to the PTO appropriation so that they could be used to help pay the costs of the Office. Under current laws, fee revenues go to the general fund of the Treasury and are not directly available to the PTO.

The fact that most of the PTO's services benefit identifiable private persons argues for a new fee structure under which those who obtain the benefits pay the costs. We have distinguished those PTO programs which mainly benefit

particular individuals from those which benefit both them and the public at large. The first category of services, for which the PTO will recover 100% of its costs, includes such things as patent reexamination, patent information services, and trademark examination. The second category of services consists of the patent application process. We believe it is fair for the general public, which benefits from the disclosure of information about an invention, to absorb 40% of these costs, through the appropriation of tax revenue, and for applicants and patentees to pay 60%.

In order to avoid raising application fees to a level which would discourage small businesses and independent inventors, the Administration bill would institute a system of maintenance fees. Three times in a patent's life, at 3 1/2, 7 1/2 and 11 1/2 years after the patent originally issued, the patentee would pay a charge for keeping the patent in force; otherwise the patent would expire. Maintenance fees are a feature of many foreign systems, such as those of the Federal Republic of Germany, France, and Japan. H.R. 6933 provides for recovering 30 percent of patent processing costs from patent processing fees and 30 percent from maintenance fees. In 1981 dollars, we estimate that the 3 1/2 year fee will be $200, the 7 1/2 year fee $400, and the 11 1/2 year fee $800. Thus, those patentees who benefit the most from the patent system will bear a larger portion of aggregate patent processing costs.

Direct appropriations to the PTO will be reduced to less than 40 percent of the cost of operating the PTO once we begin receiving the 11 1/2 year maintenance fee payment. Crediting fees to the PTO appropriation will decrease the drain on the federal budget. As the revenues from fees will be available to the Secretary to finance the PTO's activities, the PTO will gain even greater incentives to hold down costs. Crediting fees directly to the PTO appropriation account together with the new fee-setting system should encourage substantially better PTO management. Budgetary control continues as before since the PTO still would require appropriations, its budget would be subject to review by the Office of Management and Budget, and it would be limited in its use of monies by appropriation acts.

Central Court for Patent Appeals

Later this month, a representative of the Department of Justice will testify in detail regarding H.R. 3806, the Administration's bill to establish a Court of Appeals for the Federal Circuit to hear such things as patent related federal cases. Today, I want to add my own support. One of the major recommendations of the private sector advisory committee on patent policy to the Domestic Policy Review on Industrial Innovation was the creation of this court.

Extensive differences in the application of the patent law by the circuit courts of appeal are responsible for considerable uncertainty about the strength of patents and occasion much patent litigation. H.R. 3806 would create a national court with exclusive appellate jurisdiction over such things as patent-related federal cases, subject only to Supreme Court review.

Decisions to file patent applications and to invest in commercializing inventions would be improved meaningfully as a result of the greater uniformity and reliability made possible by a national appeals court. Some advisory committee members with substantial litigation experience expressed the view that the amount of patent litigation could be cut nearly in half with such a court. The bill attempts to solve a substantial and irksome problem. In addition, it should save the government and the public both time and money.

Conclusion

The Administration's patent legislation package offers a significant opportunity to make a major contribution to our industrial development. Furthermore, it provides a much improved fiscal approach, and greater economy and efficiency.

This concludes my prepared testimony. I respectfully request the right to supplement my testimony as may be necessary to respond to concerns raised during the course of these hearings.