

★

STATEMENT OF

ERIC P. SCHELLIN

ON BEHALF OF

NATIONAL SMALL BUSINESS ASSOCIATION

SMALL BUSINESS LEGISLATIVE COUNCIL

AND

NATIONAL PATENT COUNCIL

BEFORE THE

SUBCOMMITTEE ON THE CONSTITUTION

SENATE COMMITTEE ON THE JUDICIARY

HOLDING HEARINGS ON

S. 414, UNIVERSITY & SMALL BUSINESS PATENT PROCEDURES ACT

JUNE 6, 1979

*"It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise...."*

*(P.L. 85-536, as amended,  
Section 2(a), Small Business Act.)*

1948

1949

1950

1951

1952

1953

1954

1955

1956

1957

1958

1959

1960

STATEMENT OF  
ERIC P. SCHELLIN  
ON BEHALF OF  
NATIONAL SMALL BUSINESS ASSOCIATION  
SMALL BUSINESS LEGISLATIVE COUNCIL  
AND  
NATIONAL PATENT COUNCIL  
BEFORE THE  
SUBCOMMITTEE ON THE CONSTITUTION  
SENATE COMMITTEE ON THE JUDICIARY  
HOLDING HEARINGS ON  
S. 414, UNIVERSITY & SMALL BUSINESS PATENT PROCEDURES ACT  
JUNE 6, 1979

Mr. Chairman and Members of the Committee:

My name is Eric Schellin. I am Chairman of the Board of Trustees of the National Small Business Association (NSB), a multi-industry trade association representing approximately 50,000 small business firms nationwide. I am also Executive Vice President of the National Patent Council.

I am also appearing today on behalf of the Small Business Legislative Council (SBLC), an organization of national trade and professional associations whose membership is primarily small business. SBLC focuses on issues of common concern to the entire small business community. The SBLC membership and their affiliates represent approximately four million small business firms nationwide. The SBLC list of members who have endorsed a policy position paper entitled "An Equitable Policy for Small Business Patents on Inventions made with Federal Assistance" is attached. This position paper and list of associations appear as Attachments B and C.

We commend the committee for the opportunity to address the issue of under-utilization of the results of Government-financed Research & Development, especially to complete the innovation process by making available to all of us alike the benefits resulting from such R&D endeavors.

The United States has been the leading innovative nation and has created many new industries. One need only look at the major new industries started within the last fifty years, such as those involving electronics, lasers, antibiotics, synthetic fibers, instant photography and xerography. Most of these industries began as small businesses. There is still room for further innovation and it will continue, especially by small business, if provided with a proper environment. Such an environment existed for years and produced outstanding results. Our patent system contributed significantly to an environment which promotes innovation. Unfortunately, there have been disturbing recent indications that there has been a decrease in the rate of innovation and in that portion of the R&D investment devoted to new product lines and basic research. It is incumbent on all of us to look everywhere to identify sources for innovation. One area not yet properly exploited is the arena of Government-financed R&D. Today, as is known, there are as many Government patent policies as there are Government agencies. It is submitted that S.414 is progressive in that it makes sense in establishing uniform policies, at least where small business is concerned. Therefore, we fervently endorse S.414, commend the many distinguished Senators for their support of S.414 and look forward to early enactment.

Much has been written pertaining to the background of S.414. Testimony that has already been heard and will be heard demonstrates this fact. Consequently, no purpose would appear to be served to provide testimony that would be merely cumulative. Therefore, permit us today to share with you certain highlights and then pinpoint areas of concern to us.

A. It is admitted that the expenditure of public funds for R&D is in effect a government underwriting of the risk of the research effort. When big business commits its own funds for R&D, it does so by allocating only a small part of monies earned in the normal course of business. On the other hand, small business to commit funds for R&D must do so by employing hard to get investor-generated funds. Early on R&D must occur before a new product or process can be identified, but the period in the innovation cycle when this occurs is at a time when investor funds are most difficult to obtain.

B. Federal Government R&D is supported to learn something that we do not know. If that is all that is supposed to be accomplished then this can be accomplished by diffusing such gained new knowledge by publication. It seems, however, that we should make use of what we learn. Like any other type of investment, R&D is expected to yield returns. In the case of Government-financed R&D the question arises: Are the investors getting full and timely return? Are the results of federally funded R&D finding their way into the market? There is much evidence to demonstrate that current Government patent policy isolates inventions from normal risk-taking and pursuit.

C. Some opponents of this Bill have stated that it is designed to be "a vast giveaway." The way the Bill is presently constructed it is neither "vast" nor is it a "giveaway."

1. It will be remembered that only 3.5% of the total Government R&D budget is allocated to small business. Therefore, it can be safely assumed that this Bill will apply to only about 3.5% of the inventions resulting from Government R&D funded efforts. Therefore, vastness is not a problem.

2. The Bill, by having a built in recoupment factor to recover the Government-risked money, denies the pejorative term of "giveaway." Small business finds in the concept of recoupment a worthy principle. Furthermore, small business by undertaking the usual and necessary steps leading to commercial fruition commits ten times any amount the Government may have advanced. A recent study initiated by the President has confirmed this view. History has shown that there will be many more losers than winners in the endeavor to commercialize.

D. NSB and SBLC have gone record on many occasions as favoring a government-wide two-tier treatment to differentiate between small business and big business on the valid premise that small business is in fact different from big business. While this Bill possesses salutary features which will benefit small business, it should be pointed out that there is much that will benefit all others not coming within the purview of the Bill. Section 212(c) will recognize statutorily operating procedures established by the various Government agencies which favor big business. By including language of the kind found in this section, it is believed that such procedures will be immunized from attack by public interest groups. Furthermore, as big business is the major recipient of technology transfer from university-developed inventions, big business will continue to be a major participant in Government-financed R&D through participation as a licensee from universities coming within the purview of this Bill.

E. It is axiomatic that the investment of money and effort will occur where there is the possibility of the greatest return. A corollary, even more important to the axiom, is the need for small business to minimize initial risk by possessing a modicum of exclusivity for a successful commercial venture. While the degree of market success cannot be predicated in absolute terms; in an arena without patent protection a market can be directly measured by the success of acceptance of a

new product or process as success by the innovator brings in market entrants. Therefore, when entertaining a new venture -- capital or energy will flow to the development of ventures of equal potential where proprietary rights to the invention are available. It is worthwhile to note that the Bill is designed to reject the concept of permitting the Government to make a determination of rights after an invention is made. The Government lacks the ability to take into consideration market forces that form the basis for a rational business decision.

#### Special and Specific Points

1. It is believed that the Bill does not address the problem of background patent and proprietary rights. Small business takes cognizance that on some occasions it will have to divest itself of such property to achieve a common good. Unfortunately, many agencies treat small business and big business differently; arbitrarily demanding all background rights when dealing with small business while only negotiating such rights with awe and deference when dealing with big business. Therefore, we propose amending the Bill to include Section 202(f), as annexed hereto, which is designed to make it possible for any Government agency to obtain background rights but on the premise that the need for such rights will be seldom required puts the decision level at the top echelons of the agency. By this method, the need when it arises will be satisfied, but such need will have to be validly demonstrated.

2. It is noted that under Section 202(c)(7)(b) a nonprofit organization may not grant exclusive licenses on subject invention "for a period in excess of the earlier of five years from first commercial sale or use of the invention or eight years from the date of exclusive license..." We believe that this limitation is not sufficiently long with regard to small business. Creating a market may entail a large capital investment. Five years of exclusivity from the time the product is commercialized is inadequate to justify such an investment. It is recognized

that the purpose of the time limitations on exclusivity is to prevent a large company from gaining a dominant position. Where the licensee is a small business, there should be no objection to granting a longer period of exclusivity. Small business will require additional time to raise the funds and to recoup the investment made in achieving commercialization.

3. Initially some of our constituents were concerned at the possible implications of Sec. 202(d) which may arrange for devolvement of the rights to the inventor in the event the contractor does not elect to retain title. It was thought some contractors would be forced to elect to retain title and to follow through by obtaining patent protection and by undertaking to complete the other prerequisites to retain title. Upon further reflection it was realized that many of the businesses of our constituents began as spin-offs from other business enterprises and oftentimes were based on surplus technology. Therefore, we would be remiss in being a barrier in achieving a public good. Technology that may be surplus to the contractor may be the underpinning for a new enterprise; the only real regret being the loss of valued associates and employees. We recognize that providing for the birth of new enterprises is quintessential to the American business system.

In conclusion, when the Small Business Act was passed it was stated therein that "It is the declared policy of the Congress that the Government should aid, counsel, assist and, protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise..." Those words of a previous Congress was a promise. The enactment of this Bill is a promise kept!

Thank you.



ADDENDUM

Add the following to section 202:

(f) No funding agreement with a small business firm shall contain a provision allowing the Federal Government to require the licensing to third parties of inventions owned by the small business firm that are not subject inventions unless such provision has been approved by the head of the agency and a written justification has been signed by the head of the agency. In no event shall the Government require the licensing of others under any such provision unless the head of the agency determines that the use of the invention by others is necessary for the practice of a subject invention made under the funding agreement or for the use of a work object of the funding agreement and that such action is necessary to achieve the practical application of the subject invention or work object; and any such provision shall clearly state whether licensing may be required in connection with the practice of a subject invention and/or specifically identified work objects. Any such determination shall be on the record after an opportunity for a hearing. Any action commenced for the judicial review of such determination shall be brought within sixty days after notification of such decision.

MEMORANDUM

TO: SAC, NEW YORK

RE: [Illegible]

[Illegible text follows, consisting of several paragraphs of typed information, likely a report or memorandum. The text is extremely faint and largely illegible due to the quality of the scan.]

Very truly yours,  
[Illegible Signature]

The National  
Small Business  
Association Building  
1604 K Street, N.W.  
Washington, D.C. 20006  
Telephone  
(202) 296-7400



Small  
Business  
Legislative  
Council\*

June 6, 1979

The position paper -- An Equitable Policy for Small Business Patents on Inventions Made with Federal Assistance -- is supported, as of this date, by 31 members of the Small Business Legislative Council:

American Association of Nurserymen  
Washington, D.C.

Association of Diesel Specialists  
Kansas City, Missouri

Association of Physical Fitness Centers  
Bethesda, Maryland

Automotive Warehouse Distributors  
Association, Inc.  
Kansas City, Missouri

Building Service Contractors  
Association International  
McLean, Virginia

Business Advertising Council  
Cincinnati, Ohio

Direct Selling Association  
Washington, D.C.

Eastern Manufacturers and Importers  
Exhibit, Inc.  
New York, New York

Furniture Rental Association of  
America  
Washington, D.C.

Independent Bakers Association  
Washington, D.C.

Independent Business Association  
of Washington  
Bellevue, Washington

International Franchise Association  
Washington, D. C.

Institute of Certified Business  
Counselors  
Lafayette, California

Machinery Dealers National Association  
Silver Spring, Maryland

Manufacturers Agents National  
Association  
Irvine, California

Marking Device Association  
Evanston, Illinois

National Association for Child  
Development & Education  
Washington, D.C.

National Association of Brick  
Distributors  
McLean, Virginia

National Association of Floor  
Covering Distributors  
Chicago, Illinois

National Family Business Council  
West Bloomfield, Michigan

National Home Improvement Council  
Washington, D.C.

National Independent Dairies  
Association  
Washington, D. C.

National Independent Meat Packers  
Association  
Washington, D.C.

National Office Machine Dealers  
Association  
Zanesville, Ohio

National Paper Trade Association, Inc.  
New York, New York

National Parking Association  
Washington, D. C.

National Patent Council, Inc.  
Arlington, Virginia

National Small Business Association  
Washington, D. C.

National Tool, Die & Precision  
Machining Association  
Washington, D. C.

National Wine Distributors  
Association  
Chicago, Illinois

Printing Industries of America, Inc.  
Arlington, Virginia

## AN EQUITABLE POLICY FOR SMALL BUSINESS PATENTS ON INVENTIONS MADE WITH FEDERAL ASSISTANCE

One of our nation's greatest problems is the decline in the rate of productivity growth, and a major factor in this decline has been the discouragement of innovation at the small business level. Less than 5 percent of all federal research and development dollars go to small business, yet both a Department of Commerce study in 1966 and an Office of Management and Budget study in 1977 show that small business accounted for more than half of all scientific and technological developments since the beginning of this century. A National Science Foundation study for the period between 1953 and 1973 found that small firms produced 4 times as many innovations for every research and development dollar as medium sized firms and 24 times as many as the largest firms.

It has become increasingly evident that many small innovative companies are avoiding the federal research grant process simply because of the uncertainty over whether or not they will be allowed to retain patent rights on inventions made under research sponsored by federal funds. This is a problem which appears to have a fairly simple solution -- allowing small businesses to obtain limited patent rights on discoveries they have made with federal money.

Experience has shown that unless the private sector (including universities, individual inventors, and non-profit organizations) is given sufficient incentive to bring new innovation to the marketplace, the development of new technologies will decline. Given the rapid drop in U.S. productivity increases over the past few years, it is apparent that new technology development in the U.S. must be encouraged.

The federal government itself is a prime disincentive for innovation development -- inventions made under various agency grants have been allowed to waste away in government storerooms benefiting no one. The Departments of Energy and Health, Education, and Welfare, for example, often take months and in some cases years to review petitions for patent rights on inventions developed with federal grants. And, when the government decides to retain patent rights on these inventions, there is little chance that they will ever be developed. Of the 30,000 patents that the government presently holds, less than 4 percent are ever successfully licensed. This is very little return on the billions of dollars that are spent every year on research and development.

Small businesses should be allowed to obtain limited patent protection on discoveries they have made under government-supported research if they provide the additional resources needed to successfully commercialize the product. This change would provide the American marketplace with additional innovative product developments and remove the

disincentive to many small companies from participation in the federal R&D process. The benefit is not only for small business, but the American economy, as well, since small firms have been the greatest source of new jobs in the past decade.

Under present practice, the government lets an R&D contract to a small business having the expertise as evidenced by background know-how. The patents devolve to the government, but when it comes to supplying the hardware, the conventional practice is for government to go to larger business, who can manufacture with impunity, in derogation of the proprietary rights of the small business contractor. This should be changed by legislation stating that no funding agreement with a small business firm shall contain a provision allowing the federal government to require the licensing to third parties of inventions owned by the small business firm which were not conceived in the performance of work under a federal R&D grant. The only exception would be that such a provision had been approved by the head of the agency and a written justification had been signed by the head of the agency. Such action by the agency head should be subject to judicial review.

#### RESOLVED

The Small Business Legislative Council urges and supports changes in current government patent policy to allow small businesses patent protection on inventions made under government-sponsored research, provided that allowance is made to permit the government to recoup its initial funding under certain circumstances. Small business innovations developed under federal contract should be patentable by the contractor, allowing that business a reasonable time to develop the new idea commercially. Failing that, the government should provide exclusive license to such innovations, with preference to small business. These actions will provide an increased incentive to the traditionally innovative small business sector to seek R&D contracts and to commercialize new and beneficial products for the marketplace.

# # #