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STATEMENT OF
ERIC P. SCHELLIN
ON BEHALF OF
NATIONAL SMALL BUSINESS ASSOCIATION
SMALL BUSINESS LEGISLATIVE COUNCIL
AMERICAN SOCIETY OF INVENTORS
AND NATIONAL PATENT COUNCIL
BEFORE THE HOUSE OF REPRESENTATIVES
COMMITTEE ON SCIENCE & TECHNOLOGY
SUBCOMMITTEE ON SCIENCE, RESEARCH & TECHNOLOGY
HOLDING HEARINGS ON
H.R. 5175, THE UNIFORM FEDERAL R & D UTILIZATION ACT
AND
THE PRESIDENT'S PATENT POLICY PROPOSALS
FEBRUARY 8, 1980

"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.)

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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 and Chairman of the Advisory Committee of the American Society of Inventors.

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 A and B.

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 any effort to establish a uniform government patent policy is commendable and if the policy provides particular incentives to small business, such policy deserves accolades. Therefore, we fervently applaud with sincerity the fact that this committee has seen fit to take the time from other pressing business to thoughtfully consider a draft of a proposed bill: "To establish a uniform Federal system for management, protection, and use of inventions that result from federally-supported research or development, and for related purposes".

Before addressing some of the issues posed in the draft legislation, permit me to share with you the mandate under which I am able to respond to the invitation to appear on this occasion. The Small Business Legislation Council (SBLC) has confronted the lack of a uniform Government patent policy. Many of the individual small business members of some of the member associations of SBLC have met with the stark reality that they are treated by Government contracting officials with discrimination for the sole reason that they are small business. In other words, even when a Government contracting official has discretion to grant title to an invention made under a Government contract, it will be refused to small business but granted to a larger business. Worse yet, any proprietary rights gained as a result of a developing expertise garnered before small business entertains funding under a Government contract may be jeopardized with a loss of such property rights ensuing. A number of individual small business persons, some of whom are members of the National Small Business Association, shared such experiences with various committees of the Congress.

Because of the aforementioned inequities and the lack of uniform Government patent policies, the SBLC, after careful consideration, approved the following resolution:

RESOLVED

The Small Business Legislative Council urges and supports changes in current government patent policy to allow small businesses patent protection in 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.

This, then is my mandate. To summarize:

1. Small business is desirous of obtaining any patent rights on inventions made under Government-sponsored research.
2. Small business wants a first right of refusal in obtaining exclusive licenses for such developed inventions not titled to small business.
3. Small business appreciates the necessity to permit government to recoup its funding that resulted in the development of the inventions.

Proposed Bill H.R. 2414 contains the above summarized items which needs to be amended to include protection to the small business contractor with regard to his background patent rights. H.R. 2414 appears to the small business community to constitute a long sought very salutary conclusion to ameliorate a difficult problem facing small business.

President Carter in his October 31, 1979, Industrial Innovation Message to the Congress stated that he will support uniform Government patent legislation and "that legislation will provide exclusive licenses to contractors in specific field of use". More importantly to the small business community

he stated: "I will also support the retention of patent ownership by small businesses and universities, the prime thrust of legislation now in Congress, in recognition of their special place in our society". (emphasis supplied). While the President did not specifically identify the legislation about which he spoke, small business interprets this to mean H.R. 2414. I would further opine that the President intended to incorporate the concept of "exclusive licenses to contractors in specific field of use" in legislation apart from H.R. 2414.

Small business is indeed exhilarated by the support of H.R. 2414 by the President. With such support, there is now before us the delightful prospect that there will be satisfactory fruition of the efforts of so many individuals who have devoted considerable time to assisting small business. This proposed legislation favoring small business has been given careful and thoughtful consideration by the small business community. It is believed that there is a wide consensus of approval of H.R. 2414 in both houses of Congress. Support by the President constitutes the capstone.

H.R. 2414 has also become a rallying focus point for small business as evidenced from the recent results culminating in a week long White House Conference on Small Business. The treatment to be accorded small business under H.R. 2414 was indicated by the conference as being worthy of inclusion in a high priority list of recommendations which will be sent to the President. One can validly say that the matter of presenting small business contractors with title to inventions made within the purview of a Government contract has come full circle.

It must be noted however that the proposed draft legislation being considered today contains features which are of enormous interest to small business. The carrying forward of the concept that small business is to be accorded title to inventions resulting from Government sponsored research is received as a positive indication that more than lip service is to be given small business. It shows also that the President's initiatives of October 31, 1979, are indeed to be acted upon. Furthermore the draft legislation contains a feature that may be attractive to small business, namely, that there is no recoupment by the Government of funds expended by the Government in the event the invention titled to small business makes money for the small business. It should be noted that a recoupment section can be found in H.R. 2414. In view of the aforementioned SBLC resolution, I have testified on a previous occasion in favor of recoupment, even knowing that when big business gets title under extant Government patent policies there will be no recoupment. Certainly, as small business is treated favorably the proposed draft legislation has considerable merit. Perhaps such especially meritorious treatment should be included in H.R. 2414, such as by deleting the recoupment section.

On the other hand, it is noted that under H.R. 2414 small business is given preference in receiving an exclusive license on inventions owned by the Government. No such section giving preferential treatment to small business is said to be in the proposed draft legislation.

Turning now to some other specifics found in the proposed draft legislation, small business would appear presumptuous to comment on the concept of awarding to large business preselected field of use licenses. While the concept at first instance appears to have an overall salutary benefit and indeed

appears to possess considerable pro-competitive aspects, it is felt that such a concept is now only an invitation for establishing a dialogue. It would appear that the concept may be controversial, even though it may impact favorably on small business, by discouraging further economic concentration in big business as big business would only obtain a field of use license. Giving title to big business may raise the specter of a charge that the American taxpayer is subsidizing the research of Mobil or G.E., companies well endowed and capable of paying for their own research.

As discerned the proposed draft legislation gives small business some discomfort as a result of the section on "Deviation and Waivers" and portions of certain other sections. Small business believes that these sections in fact present untoward discretion in the governmental agencies to deviate from the general duties and rights described in the proposed draft legislation, that this legislation could, if administered poorly, result in a non-uniform disposition of invention rights. Again, it is submitted that the draft legislation, while having salutary features, needs either additional explanation and/or modification or both.

Small business has reservations with regard to Section 503 of the draft legislation. Section 206(b) authorizes a third party to petition an appropriate agency to exercise march-in rights under Section 206(a). Under Section 503(b) an adverse decision to such a petition is subject to appeal to the U.S. Court of Claims. Such an appeal is to be held de novo. By using these sections a deep pocket big business petitioner can tie up for years the final disposition of patent rights of small business. As time is definitely on the side of big business, small business would admit defeat.

Inasmuch as both the draft legislation and H.R. 2414 give evidence of a two-tier approach for small business with regard to title to inventions made under Government auspices, permit me to discuss the wise rationale behind such efforts. We are all aware of the numerous studies that have concluded that heretofore small business has been in the forefront of innovation. But we are now also aware that small business has become the shackled giant of innovation. If questioned, undoubtedly, representatives of big business would testify that they too have been innovative. Recently, before another committee of the Congress, I heard a witness from big business respond to just such a question by stating that fully fifty percent of the products presently sold by his company were introduced during the last ten years. I would dare say that if one would examine that fifty percent figure one would find that most of those so-called new products resulted from product differentiation, that is, they are the same products having different styling, different packaging or, also very likely, are due to acquisitions.

If big business in the U.S. is so innovative, why do I drive a foreign made car, own a foreign made camera and watch a foreign made TV. Now one might say that there are many reasons for this phenomenon. I would opine that it is not the fault of the American worker. Recent accounts demonstrate that workers in foreign owned manufacturing facilities in the U.S. give evidence of greater productivity and fewer rejects than is experienced by the foreign manufacturer in its home country.

Big business possesses enormous competence in being able to deliver a huge volume of goods and services at prices driven by an essentially free market. By inference from many studies it can be validly stated that most

big business has only a limited ability to be innovative. Therefore, we of small business see no good reason to reward failure. We see every reason to reward small business because of its proven record to which the President alluded as mentioned in the above.

It is our belief that giving title to big business will only perpetuate economic concentration and may even enhance it; it will be anti-competitive and may not necessarily give rise to innovative products. Any march-in rights retained by the Government is a specious remedy. Once having given title to an invention to big business, no one else would have an interest in commercializing such an innovation.

For this and other arguments, the small business community seeks for itself that special treatment of the kind found in H.R. 2414 and the draft legislation. We are aware that efforts are being made to give all "equal treatment" such as can be found in H.R. 5715. We say to you without equivocation that when you treat "Joe's Machine Shop" the same as G.M. you are treating "Joe's Machine Shop" unfairly; whether it concerns OSHA, taxes, regulations, depreciation schedules and, finally, title to inventions made under Government auspices. It has been well documented and concluded that it is critical to ameliorate the heretofore treatment accorded small business in the disposition of invention rights resulting from Government sponsored research.

The following statements are axiomatic:

1. Small business has been treated unfairly in the disposition of invention rights.
2. The taxpayer rarely, if ever, obtains commercial benefits from inventions resulting from Government-sponsored research.

3. Innovation is diminishing in the United States.

4. Small business has a great track record in innovation, in creating new jobs and being at the cutting edge of competition.

Therefore, the President's mandate of October 31, 1979, is best carried out by first attending to the enactment of H.R. 2414, followed by a continued consideration of the proposed draft legislation. Small business is grateful to have found an ally in the President, whose presence complements the many allies already evident in the Congress.

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



Small
Business
Legislative
Council*

February 6, 1980

The position paper -- An Equitable Policy for Small Business Patents on Inventions Made with Federal Assistance -- is supported, as of this date, by 35 members of the Small Business Legislative Council:

American Association of Nurserymen
Washington, D.C.

Association of Diesel Specialists
Kansas City, Missouri

Association of Independent Corrugated
Converters
Washington, D.C.

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
Michigan
Kalamazoo, Michigan

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

Minnesota Association of Commerce
and Industry Small Business Council
St. Paul, Minnesota

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

National Association of Brick
Distributors
McLean, Virginia

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*Of the National Small Business Association

National Association of Floor
Covering Distributors
Chicago, Illinois

National Coffee Service Association
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.

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