

## Statement on Fee Diversion Amendment

I want to thank all of the co-sponsors who have joined in support of my amendment, particularly Senators Boxer and Grassley, who recognized the importance of this amendment for the proper functioning of the PTO and for the underlying legislation.

Our Founding Fathers recognized the value that intellectual property provides to this country and sought to protect innovation as they did physical property. Article I, Section 8 of our Constitution states “The Congress shall have 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.”

It is necessary for the Federal government to protect and enforce intellectual property rights domestically and internationally. Intellectual property is important to our country, businesses and individual rights holders, and I believe a strong patent system is one crucial element in maintaining our country’s leadership in innovation, invention and investments. While I do believe it is the goal of this patent reform legislation to strengthen and improve our patent system, I do not believe that such goals are possible without reform to the financial crisis facing the patent office.

My amendment would provide an immediate solution to this crisis. The amendment creates a lockbox—a new revolving fund at the Treasury—where user fees that are paid to the PTO for a patent or a trademark go directly into the revolving fund for PTO to use to cover its operating expenses. Congress would not have the ability to take those fees and divert them to other general revenue purposes.

### **Background**

I do not think everyone in this Body understands what it means for the PTO to be a wholly fee-supported agency. PTO does NOT receive any taxpayer funds. PTO receives fees through the payment of patent and trademark user fees—fees paid by small inventors, companies and universities to protect their ideas and technology. While those that pay these fees expect efficiency and quality from the PTO, they do not receive it. Because of the current PTO funding structure—where PTO user fees are deposited into the Treasury, but PTO is then required to ask for annual appropriations—Congress, who only has authority over taxpayer funds, maintains control over the user-funded PTO. When PTO’s fee income is greater than what Congress provides via appropriations, we spend the “excess” on other general revenue purposes. As a result, those that pay to use the patent system are not receiving the quality service they deserve.

It is more than mere coincidence that the two major problems at the PTO, 1) the growing number of unexamined patent applications or “backlog,” and 2) the increased time it takes to have a patent application examined or “pendency,” are the result of a “lack of connection between the monies flowing into the agency and those available for expenditure.”<sup>1</sup> In fact, the latest data from the PTO shows that the patent processing backlog is almost 26 months.<sup>2</sup> That is, it takes 26

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<sup>1</sup> S. Rep. No. 110-259, at 34 (2007).

<sup>2</sup> United States Patent & Trademark Office, Performance & Accountability Report: Fiscal Year 2010, at 12, available at <http://www.uspto.gov/about/stratplan/ar/2010/USPTOFY2010PAR.pdf>.

months for the patent examiner to even pick up the application to take his “first action.” Total overall pendency (from filing to final action) is approximately 35 months.<sup>3</sup> The PTO also states the total number of patent applications pending is over 1.16 million,<sup>4</sup> with over 718,000<sup>5</sup> of those waiting for a patent examiner to take his first action. One of the primary reasons for these incredibly long waiting periods is a lack of resources at the PTO. By providing a permanent end to fee diversion, Congress has the ability to contribute greatly to the enhanced efficiency of this agency.

This is not the first time Congress has been confronted with its diversion of PTO user fees. Since the early 1980s, Congress has addressed issues related to this issue. Beginning in the late 1990s, our own Congressional reports have documented the problems with fee diversion from the PTO, and the domino effect it has on PTO’s efficient operation.

In 1997, the House Report on the Patent and Trademark Office Modernization Act stated, “Unfortunately, experience has shown us that user fees paid into the surcharge account have become a target of opportunity to fund other, unrelated, taxpayer-funded government programs. *The temptation to use the surcharge, and thus a significant portion of the operating budget of the PTO, has proven increasingly irresistible, to the detriment and sound functioning of our nation’s patent and trademark systems...*this, of course, has had a debilitating impact on the [PTO].”<sup>6</sup>

It is disturbing to me, and should be to all Members, that many of the same practices that this 1997 report notes as those that suffer from lack of consistent PTO funding still occur today—14 years later.

Yet, Congress continued to grapple with PTO’s funding problem into the early 2000s. In 2003, the House noted in its report on the Patent and Trademark Fee Modernization Act that “by denying PTO the ability to spend fee revenue in the same fiscal year in which it collects the revenue, an equivalent amount may be appropriated to some other program without exceeding their budget caps. Although the money is technically available to PTO the following year, it has already been spent.”<sup>7</sup> In 2007, I offered a different version of my current amendment to patent reform legislation considered by the Judiciary Committee. My amendment passed without opposition. Last year, I offered this amendment in the Judiciary Committee, and it was tabled by a vote of 10-9. Yet, in 2008, this Body adopted by unanimous consent an amendment by Senator Hatch to the FY 2009 Budget Resolution that condemns the diversion of funds from the PTO.

Clearly, for more than a decade, both Houses of Congress have recognized that many of the efficiency and operational problems at the PTO could be remedied by giving the PTO authority over its own fee collections. ***However, we have yet to take the responsibility to relinquish the control over these user fees that we think we deserve.*** In fact, in the current arrangement, Congress cannot resist the temptation to take what is not ours and divert it to non-patent related functions. This is especially tempting during bad economic times, which we have recently been experiencing. Such an arrangement flies in the face of logic, commonsense budgeting and overwhelming support from the entire patent industry for providing the PTO with a consistent

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<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at Table 3, Summary of Total Pending Patent Applications (FY 1989 - FY 2010).

<sup>5</sup> United States Patent & Trademark Office Data Visualization Center available at <http://www.uspto.gov/dashboards/patents/main.dashboard>.

<sup>6</sup> H. Rept. No. 105-32, at 32 (1997).

<sup>7</sup> H. Rept. No. 108-241, at 9 (2003).

source of funding. Ending fee diversion is one of the only areas of 100% agreement within an industry that has often been divided on other issues in this bill. My amendment is supported by PTO, Intellectual Property Owners Association (IPO), American Intellectual Property Law Association (AIPLA), International Trademark Association (INTA), The 21<sup>st</sup> Century Coalition, Coalition for Patent Fairness (CPF), Innovation Alliance, American Bar Association (ABA), U.S. Chamber of Commerce, Wisconsin Alumni Research Foundation (WARF), BIO, Intellectual Ventures, National Treasury Employees Union (NTEU), Intel, and IBM.

### **The PTO Cannot Effectively Manage the Changes Made In This Legislation without Permanent Access to Its User Fees**

I agree that there are aspects of the patent system that need to be updated and modernized to better serve those that use the PTO, and this bill makes reforms to the current patent system. In fact, one of those changes involves giving the PTO fee setting authority. Section 9 of the bill states that the PTO shall have authority to set or adjust any fee established or charged by the office *provided* that the fee amounts are set to recover the estimated cost to the PTO for its activities. This is a great provision to put in the bill, but it is only one side of the funding story. In fact, providing the PTO with fee setting authority alone is at odds with the way Congress currently funds the PTO. If I were the PTO director, why would I take advantage of this provision by increasing fees to a point where I think they would cover my operational costs, when I know that Congress has the ability to take whatever it wants of those increased fees and spend it on something other than what I budgeted those fees to cover?

In fact, PTO Director Kappos has specifically commented on fee diversion at the PTO. During his confirmation hearing in 2009, Director Kappos stated in his testimony that the PTO faces many challenges and one of the most immediate is “the need for a stable and sustainable funding model.” In his private meeting with me prior to his hearing, he discussed his experience as a high-level manager, officer and counsel at IBM. He acknowledged that, despite the vast knowledge and experience that he can bring to the PTO, he could not run PTO efficiently without access to sustainable funding.

In March 2010, Director Kappos appeared before the House CJS Appropriations Subcommittee and stated the PTO was likely to collect at least \$146 million **more than** its 2010 appropriation. **He was right,** and in July 2010, the PTO had to ask for more funds from Congress in separate legislation, **but** it was only given \$129 million. As a result, PTO ended up collecting at least \$53 million above that amount, which it could not access.

In April 2010, Director Kappos made similar comments at a meeting in Reno, Nevada. When discussing the pending Senate legislation, Director Kappos stated, “I am going to make USPTO much better whether we get new legislation or not... There is more than one way to solve our problems. Lack of funding is a real issue... It’s very hard to cut down on a huge backlog with a lack of funding... Lack of funding hits you at every corner at the USPTO. Just do the math... We’ll all be dead and gone by the time we get rid of the backlog of appeals at the current rate. It is so overwhelming and it all comes down to the resources you need. It comes down to money.”<sup>8</sup>

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<sup>8</sup> Mike Munday, “Can-Do U.S. Patent Chief Says New Law Unnecessary,” *Tech News Arizona*, April 9, 2010.

In January 2011, Director Kappos appeared at a House Judiciary Committee PTO Oversight hearing. He stated, “uncertainty about funding constrained our ability to hire or allow examiners to work overtime on pending applications during the last year.”<sup>9</sup>

It baffles me that these comments have not been heeded by Congress. Director Kappos believes much progress can be made without legislation as long as there is a sustainable funding model.

Similar words appear in the House Report on the 2003 Patent and Trademark Fee Modernization Act: “While the agency has demonstrated a commitment to embrace top-to-bottom reform consistent with congressional mandates, **it is equally clear that PTO requires additional revenue to implement these changes.**”<sup>10</sup> Yet, our PTO director, who has incredible plans for this agency, cannot accomplish those due to revenue shortfalls that have plagued the agency for decades—a problem Congress has the ability to permanently fix.

### **Congress Has NOT Ended Its Diversion of Fees from the PTO**

On a regular basis, from 1992 to 2004, the amount Congress “allowed” the PTO to keep via appropriations was less than the fees PTO collected. At the height of this problem in 1998, Congress withheld \$200 million from the PTO and diverted it to other general revenue purposes.<sup>11</sup> As recently as 2004, Congress diverted \$100 million from the PTO, in 2007, it was \$12 million, and in 2010, it was \$53 million.<sup>12</sup> In total, since 1992, Congress has diverted more than \$800 million that the PTO will never be able to recover.<sup>13</sup>

Now, beyond the concern that appropriators have with relinquishing control over PTO funding, some might say that the practice of fee diversion has ended in recent years, making this amendment unnecessary. Under public pressure from numerous sectors of the American innovation industry, in 2005 and 2006 and 2008 and 2009, it is true Congress gave PTO all of the funds it estimated in its budget request. So, some argue that no permanent solution to PTO fee diversion is necessary because of Congress’s proven restraint.

However, it is not entirely true that all fee diversion has ended. **First, it is inaccurate to say there has been no fee diversion since 2004. According to the PTO, \$12 million was diverted in 2007, and \$53 million in 2010—a type of diversion slightly different from the past.** From 1992-2004, PTO provided an estimate of its fees, but appropriators diverted funds by appropriating to the PTO **less than** its estimate and applying the difference to other purposes. In 2007 and 2010, PTO provided its estimate and, it is true, appropriators provided an amount equal to that estimate. **But, PTO collected more than what appropriators gave them, and those fees were diverted to other purposes rather than being returned to PTO the following year.**<sup>14</sup> Without access to those funds, PTO lost \$12 million in 2007 and \$53 million 2010, for a total of \$65 million.

<sup>9</sup> Statement of David J. Kappos Before the House Subcommittee on Intellectual Property, Competition and the Internet, January 25, 2011, at 1-2.

<sup>10</sup> H. Rept. No. 108-241, *supra* note 5 at 7.

<sup>11</sup> U.S. Patent & Trademark Office, Funding History Chart FY1992-FY2009, Prepared by USPTO, April 2010.

<sup>12</sup> U.S. Patent & Trademark Office, Funding History Chart FY1992-FY2010, Prepared by USPTO, February 2011.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

**Second**, Congress has engaged in “soft diversion” of PTO funds through earmarking PTO fees. From 2005-2010, appropriators directed PTO to spend its user fees on specific, earmarked items in appropriations bills totaling over \$29 million. Such items included: \$20 million for “initiatives to protect U.S. intellectual property overseas;”<sup>15</sup> \$1.75 million for the National Intellectual Property Law Enforcement Coordination Council (NIPLECC);<sup>16</sup> \$8 million for PTO to participate in a cooperative with a non-profit to conduct policy studies on the activities of the UN and other international organizations, as well as conferences.<sup>17</sup> While we all agree it is important to protect intellectual property rights abroad, PTO should be able to have discretion to decide how much of its budget should be directed for those purposes.

**Third**, the PTO faces a huge backlog of unexamined patents, as well as an enormous patent pendency problem for those applications already being processed. Fee diversion from the PTO has exacerbated these waiting periods through a Congressional Ponzi-scheme. Even if we were to accept that fee diversion stopped in 2005, CBO states that approximately \$750 million was diverted from 1992-2007.<sup>18</sup> **With the addition of the \$53 million diverted last year, the PTO has lost over \$800 million due to fee diversion.** Thus, PTO has been constantly trying to recover from years of a “starvation funding diet.”<sup>19</sup>

So, when the PTO presents a budget of what it needs to process applications in the next 1-year period, that money is actually going towards processing applications sitting in the backlog. As a result, Congress is really not providing PTO with what it needs for the year in which it receives appropriations. Rather, it is giving short-shrift to the current year’s needs because PTO must apply its fees **not** to the inventor who submitted his application this year, but to those who paid and submitted applications years ago.

### **Lack of Funding is Exacerbated Under a Continuing Resolution**

In fact, PTO’s lack of access to its user fees is further amplified in a year with a Continuing Resolution, such as this fiscal year. Under this CR, the PTO can only spend at the level given to it by the Appropriations Committee in 2010, which is approximately ***\$1.5 million per day less than*** the President’s FY 2011 budget request.<sup>20</sup>

PTO already has to wait on year-to-year funding that may not materialize, and under a CR the problem is worse since PTO cannot get access to their fees until the CR is lifted. In January, the PTO Director noted at the House Judiciary PTO oversight hearing, “our spending authority under the continuing funding resolutions and the lack of a surcharge assessment through early March, however, represent **foregone revenue of approximately \$115 million** as compared to what was proposed in the President’s FY 2011 budget request.”

Thus, under the House-proposed CR, without a specific provision inserted to allow the PTO to collect all of the fees it collects, PTO will not be able to access its future fee collections. **My amendment would solve this problem of constantly using time and resources at both the**

<sup>15</sup> Consolidated Appropriations Act, 2005, P.L. 108-447.

<sup>16</sup> Consolidated Appropriations Act, 2008, P.L. 110-161; Omnibus Appropriations Act, 2009, P.L. 111-8.

<sup>17</sup> Omnibus Appropriations Act, 2009, P.L. 111-8; Consolidated Appropriations Act, 2010, P.L. 111-117.

<sup>18</sup> Congressional Budget Office, Cost Estimate for S. 1145, Patent Reform Act of 2007, February 15, 2008.

<sup>19</sup> Marla P. Grossman, “Diversion of USPTO User Fees: A Tax on Innovation,” *Institute for Policy Innovation*, April 27, 2009 at 6

<sup>20</sup> Letter from Intellectual Property Owners Association to Senators Reid and McConnell, February 17, 2011.

**PTO and Congress to ensure the PTO receives the funding it deserves and does not suffer from Congress's inability to properly fund the government.**

**As the above problems show, even without direct diversion, PTO still faces the possibility of having its fees diverted by other means.** Thus, while I recognize that some effort has been made by Congress, it is no consolation to me or to the PTO Director that, in recent years, appropriators have “restrained” themselves and provided the PTO with all of the fees that it collected. ***“But, such recent restraint does not guard against future diversion.”***<sup>21</sup>

In 2007, the American Intellectual Property Law Association stated in a letter to House Speaker Nancy Pelosi, “there is nothing to prevent the devastating practice of fee diversion from returning... While everyone wishes for a more rapid recovery by the Office, it must be remembered that the current situation is the result of a 12 year starvation funding diet. It will take permanent, continued full funding of the USPTO...to overcome these challenges.”<sup>22</sup>

### **An Amendment to Permanently End Fee Diversion Is the Only Effective Remedy**

The only true solution to the problem of PTO fee diversion that will give solace to those in the patent community and to the PTO Director is a **permanent** end to fee diversion so the PTO can effectively and efficiently budget for its future operational needs.

The President's FY 2012 Budget also supports a sustainable funding model for the PTO. It states, “another immediate priority is to implement a sustainable funding model that will allow the agency to manage fluctuations in filings and revenues while sustaining operations on a multi-year basis. A sustainable funding model includes: (1) ensuring access to fee collections to support the agency's objectives; [and] (2) instituting an interim patent fee increase...”<sup>23</sup>

In fact, as I stated earlier, in 2008, this Body approved, by unanimous consent, an amendment to the 2009 Budget Resolution by Senator Hatch that condemns the diversion of funds from the PTO. My amendment is in the same vein—***if we will vote to condemn fee diversion, we should also vote to remedy the problem.***

I believe we cannot have true patent reform without ending fee diversion and providing the PTO with a **permanent, consistent** source of funding, which is why I believe very strongly that this amendment should be adopted. As my colleague Senator Hatch so effectively stated in Judiciary Committee markup this year, “fee diversion is nothing less than a tax on innovation.”

Finally, I would like to point out that nothing in this amendment allows the PTO to escape Congressional oversight and accountability. You have all heard me talk about the need for more transparency in all areas of our government, and this is no exception. Enacting this amendment will NOT put the PTO on “auto-pilot” or reduce oversight of PTO operations. In fact, the amendment requires extensive transparency and accountability from the PTO, giving Congress plenty of opportunities to conduct vigorous oversight.

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<sup>21</sup> *Id.*

<sup>22</sup> *Id.* citing Letter from the American Intellectual Property Law Association (AIPLA) to House Speaker Nancy Pelosi, August 13, 2007.

<sup>23</sup> United States Patent & Trademark Office, President's Budget FY 2012, at p. 7, February 14, 2011, available at <http://www.uspto.gov/about/stratplan/budget/fy12pbr.pdf>.

My amendment provides 4 different methods by which Congress will hold PTO accountable: 1) an annual report, 2) an annual spending plan to be submitted to the Appropriations Committees of both Houses, 3) an independent audit, and 4) an annual budget to be submitted to the President each year during the budget cycle. Furthermore, nothing in this amendment changes the current jurisdiction of any Congressional committee, Appropriations or Judiciary, to call PTO before it to demand information, answers and accountability. In fact, it has the potential to yield more information to Congress via the four reporting requirements than provided by other agencies.

This amendment is not about authorizers versus appropriators, but rather it is about giving the PTO and its very capable and experienced director the opportunity to improve the agency and provided top-notch service to PTO applicants. It is also about making oversight of the PTO a priority for all committees of jurisdiction. It is about stimulating our economy because when the PTO is fully funded, patents are actually granted, which creates jobs in new companies and in the development and marketing of innovative new products. It is about fulfilling our responsibility to ensure efficiency, accountability and transparency in our government so that we reduce our deficit and provide our grandchildren relief from the immense financial burden they currently bear.

Thus, to truly reform the patent system in this country, more than any legislation, it is necessary for the PTO to be able to permanently and consistently access the user fees (not taxpayer funds) it collects. Therefore, I urge my colleagues to support this amendment.