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Sent: Thursday, April 30, 2015 4:40 PM

To: WorldClassPatentQuality

Cc: Michael Denver Frakes ([email redacted])

Subject: Second Set of Enhanced Patent Quality Initiative Comments

Attached please find our second set of comments regarding the Enhanced Patent Quality Initiative.

Best,

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To Office of the Commissioner for Patents:

Commentators have noted two key concerns with the patent system in recent years—the quality of patents that the Patent and Trademark Office (PTO or Agency) issues and the crippling backlog of applications facing the PTO. We believe that these two concerns are not independent of each other. On the contrary, we feel that one of them—the backlog of applications—may be contributing to the presence of the other—the granting of low quality patents.

To understand this claim, it is important to acknowledge that the presence of a substantial backlog essentially signifies an Agency that is facing difficulty marshalling enough resources (through its fee revenue) to cover the costs of those applications awaiting review. To the extent that the backlog is indeed an undesirable outcome for the Agency, which is a reasonable assumption, this may create an incentive on the part of the PTO to find ways to either increase its revenues or to conserve resources in order to place the agency in a better financial balance and to limit the degree of its backlog. We believe that there are two ways in which the PTO may act upon this incentive to the detriment of the quality of the patents that it issues.

The first way stems from the fee structure of the Agency. Since 1991, the PTO has effectively relied upon user fees to fully fund itself. Over this time period, the Agency has garnered the vast majority of its budget from three types of fees: (1) filings, search, and examination fees (collectively, examination fees); (2) issuance fees; and (3) maintenance fees. Congress, and more recently the PTO, has set examination fees substantially below the actual cost incurred by the PTO to review applications. As a result, the Agency is heavily reliant upon back-end fees—fees the PTO only collect when it grants a patent—to subsidize the examination process and to fund its operation. This financing structure has left the PTO overly dependent upon a source of funds that would only materialize when the PTO decides to grant patents. As such, to the extent that the PTO finds itself inclined to look for an additional source of revenue in order to limit the prospects of a growing backlog, it may be tempted to elevate its grant rate, providing the potential for greater issuance and maintenance fees. Were the PTO to act upon this incentive in this manner, it might lead to the issuance of a set of lower quality patents that otherwise should have not have been allowed absent such inclinations.

In a study published in *Vanderbilt Law Review*, we find evidence suggesting that the Agency's historical fee structure indeed biases the PTO towards granting patents (this article can be downloaded at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1986542). The evidence does not suggest that the Agency universally seeks to expand its budget as it acts upon this incentive. Rather, it suggests that the Agency may only act upon this incentive during periods in which it may be especially in need of additional funds in order to stay afloat. That is, when the PTO does not have enough fee income to review the applications waiting review. As a result, this analysis does support the contention that the backlog of patent applications may be creating an incentive for the Agency to grant patents at an elevated rate in an effort to collect enough funds to meet its expected demand of examination.

The second way in which a backlog of patent applications may lead the PTO to issue low quality patents stems from an oddity of the U.S. patent system: repeat filings (i.e., continuations and Requests for Continued Examination). The inability of the Agency to finally reject a patent application could potentially overwhelm the existing examination infrastructure. The fact that the Agency faces a backlog of over 600,000 patent applications of which close to 40% constitute repeat filings suggest this is already occurred. Because examination fees are set substantially below the costs incurred to review an application, the PTO cannot simply hire additional examiners to address any uptick in repeat filings. A PTO that seeks to decrease (or slow the growth of) its backlog could potentially decrease the number of application awaiting review by elevating its grant rate. That is, by allowing patents earlier on in the examination process the Agency could take away the incentive of applicant to file repeat applications altogether.

In a second paper published in *Stanford Law Review* (this article can be downloaded at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2426321), we find evidence suggesting that the PTO has acted on this incentive. More specifically, we find evidence that the PTO is over granting patents during times in which the Agency lack sufficient resources to meet its expected demand of examination. Similar, to our study in *Vanderbilt Law Review*, we emphasize that it is only when the Agency lacks sufficient resources to review awaiting patent applications that we find any evidence of the PTO biasing its grant rate upwards.

Our findings in these studies suggest several avenues of reform. First, we believe that budgetary constraints facing the Agency need to be more carefully and explicitly considered during the fee-setting process. The optimal fee schedule should consider not only the incentives and social welfare of patent applicants and society but also the Agency's needs for financial sustainability and the incentives facing an Agency that is under resource duress. Second, through a revision of the Agency's historical fee structure, Congress and the PTO may hopefully circumvent the sources of financial instability that may lead to the crippling backlog in the first place (thereby, alleviating the harms arising from any incentives created by the presence of a backlog—i.e., the harms of issuing low quality patents in the face of mounting backlogs). In this light, we encourage the PTO to consider raising examination fees in an effort to better align exam fees with exam costs and to decrease the Agency's reliance on post-allowance fees. This may create

better stability by ensuring that fee revenues increase lock step with any unexpected growth in examination demand of the agency (which would not necessarily occur to the extent the agency is overly reliant on fees derived from the past stock of patent grants). At a minimum we encourage the PTO to raise the filing fees for RCEs and continuations to cover the costs incurred by the Agency to review these repeat filings.

We acknowledge that the America Invents Act may force the Agency to lower renewal fees should it wish to raise examination fees as we have just proposed, an outcome that could be undesirable to the extent that renewal fees serve an important public function. In order to retain this valuable function of renewal fees while ensuring better financial stability at the PTO (which again will require higher examination fees), we encourage Congress and the PTO to no longer include renewal fees as a financing tool for the Agency. Instead, we recommend that renewal fees paid by grantees be diverted to a special fund that cannot be spent by the Agency itself. In order to offset the harms to certain applicants—e.g., small entities—that may arise from higher examination fees, the proceeds deposited in this special fund could be used to subsidize the examination fee costs for small and micro-inventors.

We believe that all of these proposals would help improve the financial health of the Agency and potentially blunt incentives to grant additional patents and hence increase the quality of patent examination.

Thank you very much for your time and consideration.

Sincerely,

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