

Ms. Michelle Picard
Office of Chief Financial Officer
Director of the United States Patent
and Trademark Office
P.O. Box 1450
Alexandria, VA 22313-1450
United States of America

October 30, 2012

Dear Ms. Picard,

The fee schedule recently proposed by the PTO shares many of the same structural features as the Agency's historical funding structure. While this proposal has many virtues, we are concerned that the retained structure remains flawed and may continue to put the Agency in a precarious position where it is unnecessarily dependent upon post-allowance fees.

Since 1991, the PTO has effectively relied upon user fees to fully fund itself. Over this time period, the PTO has garnered the vast majority of its budget from three types of fees: (1) filing, search, and examination fees (collectively, examination fees), (2) issuance fees, and (3) maintenance fees. The latter two fees – i.e., post-allowance fees – are necessarily only collected by the Agency if it issues a patent. Congress, in an effort to promote access to the patent system, had historically set examination fees substantially below actual cost incurred by the PTO to examine applications. In contrast, Congress set both issue and maintenance fees substantially above the cost to the PTO to issue and maintain a patent. As a result, since 1991 the PTO has garnered over half of its patent operating budget through post-allowance fees.

Of course, maintenance fees have generally been viewed as more than a mere financing mechanism. Considering that inventions covered by patents will re-enter the public domain when patentees let maintenance fees lapse, we acknowledge that such fees serve the valuable purpose of effectively shortening patent terms for arguably invaluable patents.

Nonetheless, despite the likely merits of maintenance fees and of low examination fees, this financing structure has left the PTO in a position where it is heavily reliant upon post-allowance fees to subsidize the examination process and to fund the Agency's operations. That is, this structure has left the Agency overly dependent upon a source of funds that would only materialize if the PTO decided to grant patent applications in the first place. This creates a potentially disturbing incentive on the part of the Agency—that is, the incentive to grant an unnecessarily large number of patents.

The AIA was, in part, enacted in reaction to the perception that the Agency issues too many invalid patents. A PTO that is somehow biased towards allowing patents on inventions that are already known is likely to be routinely granting patents that end up imposing significant costs on society—through monopoly prices and diminished consumer access—without bestowing the commensurate benefits of stimulating innovation. A fee structure that relies so considerably upon post-allowance fees only solidifies this concern by pinpointing a potential source of Agency bias.

In a study forthcoming in the *Vanderbilt Law Review*, we find evidence indeed suggesting that the Agency's historical fee structure 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. To be clear, we only mean to suggest that this evidence is consistent with a story in which the Agency's funding structure induces a bias towards granting. While we attempt to rule out a relatively large number of competing explanations for the granting patterns observed in the data, we cannot absolutely conclude, as few empirical studies of this nature can, that the Agency's fee structure has truly caused an increase in granting behavior. Considering the high likelihood that PTO fee collections may fall short of budgetary expectations due to various developments (e.g., lower-than-expected renewal fee collections, greater-than-expected share of small-entity filers, etc.), we remain concerned with the structural observation that the Agency is effectively required to achieve a particular grant rate in order to break even. As such, we remain concerned that the Agency may have no choice at times but to turn to distortionary granting practices.

Although the Agency should be commended for considering key policy factors such as fostering innovation and facilitating effective administration of the patent system during its deliberative process of setting its fees, the new fee schedule proposed by the PTO maintains the same weakness of the historic schedule. The PTO modestly increased its examination fees, decreased issuance fees, and substantially increased maintenance fees. However, the ratio of pre-allowance and post-allowance fees remained virtually unchanged. As such, the Agency will continue to remain heavily dependent upon a set of fees that it only collects if patents are granted. As a result, we are left with the same concerns emphasized above. Admittedly, while a financially constrained PTO could raise fees in an effort to cover its expenses, the duration of the fee-setting process limits the ability of the Agency to immediately augment its revenue through fee increases. Thus, the Agency, even with fee-setting authority, may turn to granting patents in an effort to increase fee collections.

We believe that the budgetary constraints facing the PTO 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 PTO's needs for financial sustainability. As a result, we encourage the PTO to consider raising

examination costs in an effort to better align exam fees with exam costs and to decrease the Agency's reliance on post-allowance fees. Further, we encourage the PTO to divert renewal fees to a special fund, wherein access to this special fund would be limited to subsidize the examination fee costs for small and micro-inventors. We believe that both of these proposals would help to reduce financial sustainability risks to the PTO, potentially blunt incentives to grant additional patents, and still maintain renewal fees and allow for access to the patent system.

Thank you very much for your time and consideration.

Sincerely,

Michael Frakes, Assistant Professor and Jia Jonathan Zhu and Ruyin Ruby Ye Sesquicentennial Faculty Fellow, Cornell Law School.

Melissa Wasserman, Assistant Professor and Richard W. and Marie L. Corman Scholar, University of Illinois College of Law.