How? The correlation between stated cause and the two stated effects is far from self-evident. This is a failure of the obligation to disclose rationale, discussed above in § V.A. Maybe there's a sound cause-and-effect. Maybe not. The provided materials do not explain. That's arbitrary and capricious under the Administrative Procedure Act.

The PTO's materials state that the fee is intended to "encourage" applicants to do something. That violates the limits of § 10(b)(2), and it's an unconstitutional "tax." See §§ I.A and I.B.

The proposal identifies no statutory authority. 35 U.S.C. § 41(h)(3) and AIA § 10(h)(1) use the word "shall" to specify that the PTO must offer a discount or surcharge for filing by "electronic means," at a specific amount. There's no further discretion to discriminate among various "electronic means," no carve-out from "shall" to authorize higher or lower discounts depending on whether a document is filed in PDF or DOCX form, and no delegation of discretion to set an amount.

The fee spreadsheet estimates the unit cost at "n/a." The indication "n/a" is used for a number of other line items where the cost is minimal. This is a new fee, not an adjustment of an existing § 41 fee, and thus AIA § 10 doesn't apply. The IOAA does, and the IOAA caps the agency's user fee at the agency's cost.[28]

How will shifting from PDF to DOCX affect applicants' recordkeeping requirements and costs? There's a lot of benefit to PDF's—with a PDF, it's always clear *exactly* which version was submitted to the PTO, even if there were many versions of the DOCX. A PDF *always* looks exactly the same, no matter what computer it's opened on, no matter what font cartridge happens to be loaded in a given printer. The same can't be said for DOCX files. I've had situations where a Word document printed on one printer has one more line per page than when printed on another printer—trying to page-cite to a document that is in the PTO's IFW will be unreliable. The PTO will have to estimate the recordkeeping costs of this randomness, and the costs of developing and changing recordkeeping practices, under the Paperwork Reduction Act. And all transition costs.

The PDF format is an open specification—there are multiple vendors that provide PDF tools, many of which are free. There is only one vendor that supports DOCX. There are still attorneys that use WordPerfect—the costs to them will be quite high. WordPerfect's conversion feature is much less than reliable. DOCX files are more prone to viruses and malicious code. If the PTO goes forward, the PTO's Paperwork Reduction Act certification, E.O. 12,866 Regulatory Impact Analysis, and Regulatory Flexibility Analyses will have to discuss and show positive benefit-cost.

Drawing submissions are generally in PDF file format and generally cannot easily be made in the DOCX format, so the Office will receive PDF submissions anyway. This is particularly true for provisional applications, where drawings embedded in the text are especially common. The PTO will have to confer with the public to estimate those costs.

---

[28] see § I.C (IOAA) above

Maybe the PTO's cost savings make this a good idea. Maybe not. But because the PTO didn't do the required regulatory analysis, and gave no visible consideration whatsoever to the costs that would be placed on the public, right now there's no reason to believe it *is* a good idea. (Remember, the burden of proof is on the agency.) Again, had the PTO done the regulatory analysis required by law, the public costs and other obvious flaws in this proposal would have been caught, and we'd either have a sounder, more-developed version of this proposal, or it would have been dropped.

## IV. The "operating reserve"

I agree in principle with the PTO's operating reserve. But I can't figure out how it's legal.

I was unable to locate a statutory authorization for the operating reserve. It's not fairly within the text of AIA § 10, which limits PTO fee collections to "only" aggregate costs. The House report reinforces this reading.[29] Neither the 2012 Notice of Proposed Rulemaking nor the 2013 Final Rule notice discuss statutory authority for the operating reserve.[30] It's inconsistent with the IOAA, which bars agencies from collecting user fees to cover agency priorities, unless Congress grants express authority.

Further, the legislative history suggests that Congress intended that the PTO *not* have an operating reserve. In fall 2011, Sen. Coburn proposed an amendment that would have given the PTO an operating account outside the normal appropriations process, which (arguably) would have given the PTO the authority to raise funds that it could hold for its own future expenditures. That amendment was not adopted, because of constitutional concerns—an agency can only spend when the money is *appropriated*.

Sen. Coons' "Big Data for IP Act" S.2601[31] would add a statutory authorization for the operating reserve. That would meet my concern. Rep. Chabot's bill, "Study of Underrepresented Classes Chasing Engineering and Science Success Act of 2018" H.R. 6758[32] only extends existing authority by eight years, without changing the scope of that authority.

A good idea is only a good idea if it's legal. I urge the PTO to educate Rep. Chabot so he can track Sen. Coons' approach. If the PTO does not gain statutory authority for the operating reserve in time for this rule to go final, I urge the PTO to consider whether acting outside the law, just because it seems like a good idea, is in fact a good idea. The PTO only succeeds to the extent that the pubic is confident in the PTO's commitment to the rule of law and its mission. Conversely, a lawless act by senior officials percolates down, and might contribute to a culture

---

[29] See excerpts from the House report at § I.A at page 6.

[30] Patent and Trademark Office, *Setting and Adjusting Patent Fees, Final Rule*, 78 Fed. Reg. 4212 (Jan. 18, 2013)

[31] https://www.congress.gov/bill/115th-congress/senate-bill/2601

[32] https://www.congress.gov/bill/115th-congress/house-bill/6758

of disrespect for the rule of law within the rest of the agency. Respect for the rule of law builds good will with stakeholders outside the agency. Is the operating reserve worth compromising that?

## V. The PTO must disclose its fee-setting data, assumptions, and methodology—without that disclosure, the September 6, 2018 hearing is inadequate to satisfy the statute

We are at the first step of fee-setting provided by Section 10(d) of the AIA:

1. The PTO publishes a 30-day notice of PPAC public hearing (AIA § 10(d)(2)(A)), which may (apparently) double as a 45-day notice before a Notice of Proposed Rulemaking.
2. PPAC holds that hearing (AIA § 10(d)(2)(B)).
3. PPAC provides a written report "setting forth in detail the comments, advice, and recommendations of the committee regarding the proposed fee" (AIA § 10(d)(2)(B)).
4. The PTO considers and analyzes "any comments, advice, or recommendations received from the relevant advisory committee"
5. Then the PTO follows all the rules that apply to a substantive rule (AIA § 10(a)(1)) (a particularly helpful timeline of that rulemaking process is in one of my earlier comment letters)[33]

Obviously each step is conditioned on the steps before—the process can't continue to step 3 until steps 1 and 2 are completed, with full i-dotting and t-crossing of procedural requirements.

The hearing of September 6, 2018 does not meet the definition of "public hearing" within the meaning of the administrative law. A "hearing" requires notice. Notice requires advance disclosure of an agency's rationale, data, assumptions, and methodology, so that the public can meaningfully participate and inform the agency. And PPAC can't perform its required review if the analytical information isn't in the materials the PTO provides.

There are two fundamental problems with the Notice of Hearing and the PTO's supporting web page:

- For computing "aggregate" costs, the PTO disclosed only methodology but no numbers.
- For line item unit costs, the PTO disclosed rabbit-out-of-hat numbers, but no basis for them—there's no underlying data, no assumptions, no models, no methodology.[34]

---

[33] https://www.uspto.gov/patents/law/comments/boundy23may2011.pdf This link is dead as of July 7, 2018 and September 5, 2018. I urge the PTO to put that letter back up, and refer all rulemaking staff to it. It has an extraordinarily helpful step-by-step guide that integrates all requirements of the APA, PRA, RFA, various Executive Orders, and the like. It would save the PTO a good deal of trouble (and occasional embarrassment) to use it. I can provide a replacement if the 2011 copy is lost.

[34] This violates the "objectivity" and "reproducibility" commitment that the PTO took onto itself and promised the public when it implemented the Information Quality Act. U.S. P.T.O *Information Quality Guidelines*, https://www.uspto.gov/learning-and-resources/information-quality-guidelines

Until the PTO discloses both numbers and supporting methodology (rather than one or the other, but never both), there's no adequate disclosure. Without disclosure, September 6 is not a "public hearing." Without a PPAC public hearing, the fee-setting rulemaking process does not advance along the timeline set out above. I urge the PTO to go back to square one, and follow the law that governs rulemaking. Doing the Right Thing now will set back the process only two or three months. Without a public hearing (and correction of the administrative law defects I note in this letter), the PTO's fee rule will be highly vulnerable to being set aside by OMB or a court, and that will set back the process by years.

### A. Rulemaking law: a hearing requires notice, and notice requires disclosure

The statute that governs rulemaking, 5 U.S.C. § 553, applies to both rulemaking by notice-and-comment and by hearing (e.g. § 553(c)). One of the requirements of § 553 rulemaking is that the agency make available its data, assumptions, computer and other analytical models, and the like. Additional laws are also applicable to this fee-setting rule, including the Paperwork Reduction Act,[35] Information Quality Act,[36][37] and Executive Order 12,866,[38] and they require the same kinds of disclosure If an agency uses any kind of mathematical or computer modeling, the agency must "explain the assumptions and methodology used in preparing the model" and "provide a complete analytic defense" if the model is challenged.[39] Release of summary information is insufficient to meet an agency's duty to disclose its models, data, and assumptions.[40]

---

[35] The Paperwork Reduction Act and its implementing regulations require the agency to consult with the public to solicit comment to "evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used." 44 U.S.C. § 3506(c)(2)(A)(ii); 5 C.F.R. § 1320.8(d)(1).

[36] Public Law 106-554 § 515, codified in notes to 44 U.S.C.A. §§ 3504 and 3516. U.S. Patent and Trademark Office, Information Quality Guidelines (PTO IQG) (see footnote 34). The PTO is required to meet requirements for "transparency" and "reproducibility" in information it disseminates or allows itself to be influenced by. Bare lines in spreadsheets are not transparent and cannot be reproduced.

[37] PTO's Information Quality Guidelines, http://www.uspto.gov/web/offices/ac/ido/infoqualityguide.html, § VII(B) ("when asked the USPTO does provide disclosure of the data sources that have been used and the specific quantitative methods and assumptions (if any) that have been employed."); *Engine Mfrs' Ass'n v. EPA*, 20 F.3d 1177, 1181–82 (D.C. Cir. 1994) (R.B. Ginsberg, J.) (APA requires agency to make available "data and studies in intelligible form so that public sees 'accurate picture of reasoning' used by agency to develop proposed rule")

[38] Executive Order 12,866, § 1(b)(6) and (7) ("Each agency shall base its decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation.")

[39] *Owner-Operator Independent Drivers Ass'n v. Fed Motor Co.*, 494 F.3d 188, 199 (D.C. Cir. 2007) (rule invalid when agency failed to provide opportunity for comment on the validity of the agency's data, assumptions, and model); *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 535 (D.C. Cir 1983) (agency has "affirmative 'burden of promulgating and explaining a non-arbitrary, non-

No public rulemaking proceeding is meaningful unless the agency discloses all material facts in time to permit meaningful public analysis, so that the public has fair notice and meaningful opportunity to comment and challenge the agency's basis.[41] The information must be made available during the notice and comment period in the rule making file, so that the information can be vetted by the public. The case that's cited in every treatise is *Connecticut Light & Power v. Nuclear Regulatory Comm'n*:[42]

> The purpose of the comment period is to allow interested members of the public to communicate information, concerns, and criticisms to the agency during the rule-making process. If the notice of proposed rule-making fails to provide an accurate picture of the reasoning that has led the agency to the proposed rule, interested parties will not be able to comment meaningfully upon the agency's proposals. As a result, the agency may operate with a one-sided or mistaken picture of the issues at stake in a rule-making. In order to allow for useful criticism, it is especially important for the agency to identify and make available technical studies and data that it has employed in reaching the decisions to propose particular rules. To allow an agency to play hunt the peanut with technical information, hiding or disguising the information that it employs, is to condone a practice in which the agency treats what should be a genuine interchange as mere bureaucratic sport. An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary.

### B. What is there, what isn't

Director Iancu's letter to PPAC recommends that "further background material that will aid in your analysis" is available at a web page.[43] I checked that page first on Sunday August 12, and again on Monday September 3 (only three days before the "hearing"). The information

---

capricious rule.' … The agency must 'explain the assumptions and methodology used in preparing the model' and, if the methodology is challenged, must provide a 'complete analytic defense.'").

[40] *Washington Trollers Ass'n v. Kreps*, 645 F.2d 684 (9th Cir. 1981) (high-level summary, without underlying model or data to "enable an interested or affected party to comment intelligently," is arbitrary and capricious).

[41] *Solite Corp. v. EPA*, 952 F.2d 473, 484 (D.C. Cir. 1991) ("Integral to the notice requirement is the agency's duty 'to identify and make available technical studies and data that it has employed in reaching the decisions to propose particular rules… An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary.'")

[42] *Connecticut Light & Power Co. v. Nuclear Regulatory Comm'n*, 673 F.2d 525, 531–32 (D.C. Cir. 1982); *see also Kern County Farm Bureau v. Allen*, 450 F.3d 1072, 1076 (9th Cir. 2006) ("Integral to an agency's notice requirement is its duty to 'identify and make available technical studies and data that it has employed in reaching the decisions to propose particular rules. An agency commits serious procedural error when it fails to reveal portions of the technical basis for a proposed rule in time to allow for meaningful commentary.'").

[43] https://www.uspto.gov/about-us/performance-and-planning/fee-setting-and-adjusting

available on that page is completely inadequate to even identify what the PTO's underlying facts, assumptions, and models are, let alone to comment on them, or integrate them into my comments on specific provisions.

**For PTO aggregate cost.** I've gone through all the materials provided, and there's apparently no disclosure whatsoever of total "aggregate cost."[44] I imagine it's somewhere in the range of $2-3 billion per year—but there's no such number in any of the materials provided. The Power Point slide deck, *Patent Fee Proposal, Detailed Appendix*,[45] has Appendix F (slides 47-55) titled "Aggregate Revenue Information." Appendix F gives bar charts that show how various 100% pies are sliced, but ***there's not a single aggregate revenue number***.

Neither the public nor PPAC can meaningfully analyze or comment on whether the PTO's proposed fees are set to "aggregate cost" if neither "aggregate cost" nor "aggregate revenue" of the proposal are disclosed.

**For line item unit costs**, the *Current Proposed and Unit Cost* spreadsheet[46] gives "unit cost" numbers for each line item, for each fiscal year. But there's no disclosure of where those numbers came from. My understanding is that examiners do not keep daily time sheets analogous to an attorney's diary, recording specific tasks and the time spent on those tasks. My understanding is that the data collected that's closest to the *activity* level (where "activity" is at the granularity of the fee schedule) is biweekly time sheets that list tasks completed during that biweek. In contrast, in the 2018 fee-setting web page materials, the only data mentioned is that the PTO collects data to segregate its costs into *extremely* coarse categories, "the organization that spent the money, the activities the money was spent for, and the type of expense (*e.g.*, salaries, benefits, printing, rent)."[47] That's even less relevant to fee-setting line items than examiner biweek time sheets. As far as I know, the PTO collects no data that directly measures costs of particular tasks at the granularity of the fee schedule, and—more relevant legally—the materials contain no disclosure of any such data collected by the PTO.

I surmise that the PTO has taken the aggregate coarse-grain data that it describes in the materials, and has reverse-engineered fine-grain line-item costs out of that aggregate? That's a very cool trick, and *extremely* difficult in most technology areas (for example, trying to turn a low-resolution photograph into a high-resolution photograph is *very* difficult). I'm curious as a technical matter—how was it done? More importantly, the law requires disclosure too. The

---

[44] PowerPoint slide deck, *PPAC Executive Summary*, https://www.uspto.gov/sites/default/files/documents/PPAC_Executive_Summary.pptx slide 17 (retrieved Aug. 12, 2018) shows total cost of examining an application, but not the total "aggregate cost" for the patent operation.

[45] https://www.uspto.gov/sites/default/files/documents/PPAC_Detailed_Appendix.pptx (retrieved August 14, 2018).

[46] https://www.uspto.gov/sites/default/files/documents/Table_of_Patent_Fees_-_Current_Proposed_and_Unit_Cost.xlsx (retrieved Aug. 12, 2018)

[47] PowerPoint *Detailed Appendix* (*supra* note 45), Appendix C, at slide 28

materials provided on the web site give no insight how the coarse-grained data that was relied on was translated into fine-grained line items that indicate what tasks or applications examiners spent time on.

The best disclosure of methodology is in a Power Point slide deck, *Patent Fee Proposal, Detailed Appendix*,

- For aggregate cost estimating, this deck tells us that the PTO's activity-based costing methodology is very good. But there's no disclosure of what that methodology might be—the public is left to take the agency's word for it. Is the "activity-based costing" directed at accounting at the granularity of the fee schedule line-items? ***Or is the PTO's accounting directed at something else?*** Activity based-costing to distinguish "salaries, benefits, printing, rent" might be methodologically strong to track those four, but useless for costing out a schedule of 500± fee line items.
- Appendix B, "Background on Fee Setting Methodology and Analysis," is indeed, *only* "background"—a walk-through of the law governing fee setting, and some of the goals and "philosophy" of the PTO. But there is no disclosure of the actual "analysis" used, only a mention that some methodology and analysis exists behind some curtain. In some ways, this is the worst approach for an agency to take—to announce that certain influential information exists, but then to fail to disclose it.
- Appendix C, "*Background on Activity-Based Information (ABI) Costing Methodology (Unit Cost Calculation)*" is again, only "background." This section states that the PTO uses "activity-based costing" and has done so for 20 years. **But there's no data.** Appendix C reports that "There has never been a material weakness in internal controls reported concerning the ABI methodology or data"—that may be true for the purposes that the Inspector General has audited (for example, whether examiners actually work the hours they reported, and for rents paid), but there's no obvious correlation between the PTO's existing ABI data, Appendix C, and the line items of the proposed fee schedule. Nowhere do the materials make any representation that any such correlation exists, let alone provide analytical support.
- Indeed, Appendix C tells us that the PTO tracks coarse-grain information like "salaries, benefits, printing, rent" but does not even hint that the PTO has any valid basis to estimate hours spent or costs for the relevant line item categories ("basic filing fee," "search," "examination," "independent claims in excess of three," "claims in excess of 20," etc.) There's nothing in Appendix C that suggests that the PTO has any cost-accounting methodology to cost out the difference between "RCE—1st Request" vs. "RCE 2nd and Subsequent Request." Appendix C does not aver that what the PTO *does* measure has any relevance whatsoever to what *should* be measured for *fee setting*, let alone explain what those measurements would be.

It looks like the PTO is in the position of the man in the old joke who's looking for his glasses under a lamppost. But he can't find them. A bystander asks, "Where did you drop them?" "Over there in the next block." "Why are you looking here?" "Because the light is better." We can't create light where it doesn't exist. Similarly, the PTO has the data it has, has to work with what it's got, and we can't wish for the data that just doesn't exist. No one's asking for perfect methodology. Tenuously-related coarse-grain data is better than no data. But if that's the best the PTO has got, then the PTO needs to be honest about it, and disclose what it's got and how it gets from that coarse-grain data to its fine-grain results. It may be possible to extrapolate from "methodologically strong" accounting for one coarse-grain purpose to minimally valid accounting for another. It's entirely possible that the PTO has developed a methodologically-sound mechanism for recovering fine-grain phenomena from coarse-grain data, and can provide legally-adequate support for the line items of the fee proposal. But the provided materials are nowhere near a legally-adequate disclosure.

The rather harsh language of "bureaucratic sport" and "hunt the peanut" of *Connecticut Light and Power* applies here. Justice Ginsburg, while still on the D.C. Circuit commented similarly: an agency's "page after page of impressive looking but utterly useless tables" that the public cannot understand without access to other unavailable information, and assumptions stated in "complete gibberish to anyone on less than intimate terms with the inner workings of the agency" are inadequate support for a rule.[48] A reviewing court is required to be rather skeptical when reviewing this kind of purely procedural issue. In absence of adequate supporting materials, could easily conclude that the PTO is trying to evade something by providing beautiful-but-irrelevant PowerPoints in order to obscure what's really going on.

The PTO will have to provide a supporting document that shows the PTO's work. The legal standard under the Administrative Procedure Act and Information Quality Act is very close to the patent standard for "enablement"—"show your work" enough to establish "objectivity," "transparency," and "reproducibility." The required disclosure likely includes at least a spreadsheet with the computational rows unlocked.

In section I of this letter, the law provides a methodology that should (must, actually) be used in the absence of data.

### C. Correct disposition—a "do over"

A very similar situation arose earlier this year, and the D.C. Circuit allowed the agency to cure the problem by publishing the omitted data and extending the period for written comments.[49]

Here, the statute calls for a "public hearing" by PPAC, with 30 days for public study. The data, assumptions, models, and analysis aren't there. The PTO will have to start over with a proper disclosure, so that the public and PPAC can review the PTO's data, and inform PPAC of relevant views. PPAC cannot conduct the statutorily-required "public hearing" until the public has a *bona fide* chance to participate on an informed basis. That can't happen until the PTO reveals its secret data, assumptions, and models. I urge that the hearing be rescheduled 30 days after all required regulatory analysis materials are available to the public.

---

[48] *Engine Mfrs' Ass'n v. EPA*, 20 F.3d 1177, 1181–82 (D.C. Cir. 1994) (R.B. Ginsburg, J.).

[49] *North America's Building Trades Unions v OSHA*, 878 F.3d 271 (D.C. Cir. 2018).

## VI. The real problem—absence of a knowledgeable and powerful compliance function within the PTO

Every private sector company that functions within any kind of regulatory scheme has a compliance officer—someone who knows the relevant law *deeply*, has the power to block company actions that would violate the law, and that functions as a problem-solving coach to help the company integrate the law into regular business operations. The PTO has no such compliance function. It's not clear whether the problem is that the agency lacks the expertise in administrative law (though the PTO's submissions to OMB under Executive Order 12,866 the Paperwork Reduction Act have been strikingly deficient, suggesting that lack), whether people with expertise lack platforms from which to influence agency decision-making, or whether the people with responsibility for bringing in user fees have so much more influence within the agency that issues of legal compliance simply disappear from sight.

In 2011, the Obama administration issued an Executive Order that directed all agencies to conduct an internal regulatory self-evaluation, and to ask the public for suggestions to improve the agency's regulations and regulatory process. The letters are on the PTO's web site.[50] I wrote one letter[51] (yet another of my comment letters that has "disappeared" from the PTO's web site). Another letter [52] came from Dr. Richard Belzer, a Harvard-trained PhD economist, who was formerly on the regulatory oversight staff at OMB, in the office that oversees agencies to ensure that agency regulations serve the public interest. His letter identifies the problem precisely—lack of any compliance function (or lack of a compliance function with any power to influence agency behavior):

> USPTO is a longstanding, serial violator of established regulatory principles. This is the product of a bureaucratic culture that treats presidential direction as interference, is adamantly opposed to basing regulatory decision-making on informed analysis, and has serious difficulty adhering to the rule of law. Each of these deficiencies is by itself a likely reason for bureaucratic failure, but in combination, they make success virtually impossible. Correcting them requires a radical change in the organization's culture.
>
> An important step forward would be for the Director to appoint a qualified individual charged with reforming the Office's culture and to delegate to this person both the responsibility and the authority to make it happen. Tasks would include replacing counterproductive existing internal systems with modern ones designed and implemented to ensure that the Office complies with statutory requirements (e.g., the Administrative Procedure Act, the Paperwork Reduction Act, and the Regulatory Flexibility Act) and

---

[50] https://www.uspto.gov/patent/laws-and-regulations/comments-public/comments-improving-regulation-and-regulatory-review

[51] See footnote 33.

[52] Richard Belzer, PhD, letter Comments on "Improving Regulation and Regulatory Review; Request for information" (76 Fed. Reg. 15891), https://www.uspto.gov/sites/default/files/patents/law/comments/belzer14apr2011.pdf (Apr. 14, 2011)

> presidential directives (e.g., Executive Orders 12866 and 13563, OMB's Bulletin for Good Guidance Practices, OMB's Information Quality Guidelines, and OMB Circular A-4). Systems need to be established to ensure that rule-writing staff do not backslide at a later date. At a minimum, a number of personnel reassignments no doubt would be necessary.

I have not detected any action by the PTO to implement the suggestions it sought in 2011. I urge PPAC to read Dr. Belzer's letter in full. Mine might be helpful as well.

PPAC should ask probing questions of PTO staff. How did today's fee proposal ever see light of day outside the Office, without the multiple legal errors being caught? Did the PTO do the public preliminary vetting (for example, with AIPLA, ABA-IP, IPO, IEEE-USA, and the like) that the Paperwork Reduction Act requires *before* rule proposal stage?[53] If not, why not? Were there *any* lawyers in the loop in this proposal, or is this proposal solely the product of financial office staff? Where were the PTO's General Counsel and Deputy Commissioner for Patent Examination Policy, the two legal officers that should have been able to see the problems (in absence of a compliance department)? Given the PTO's record of losing cases on lack of statutory authorization and attempts to "end-run" the laws that govern rulemaking,[54] how did the PTO's lawyers miss all the statutory authority and rulemaking procedure issues in this proposal? Does the PTO have any person with competence in administrative law, someone whose competence is comparable to the level that any private sector business would require from its compliance staff? Does this person have sufficient authority within the PTO to ensure agency compliance? Why wasn't this person in the review chain? Why was there no disclosure as

---

[53] The requirement to "consult with members of the public" *before* first publication is not literally in the text of the statute, but arises out of the interdependencies between required steps, and the practical reality that most agencies have no internal source of objective compliance cost information, and can only obtain objective cost information by conferring with the public. The requirement arises by working backwards through various requirements. For information collection requests contained in a proposed rule, 44 U.S.C. § 3507(d)(1)(A), 5 C.F.R. § 1320.5(a)(3) and § 1320.11(b) require that an agency submit an ICR to OMB "as soon as practicable, but no later than the date of publication of a notice of proposed rulemaking in the Federal Register." An agency also is required, by 44 U.S.C. § 3507(a)(1)(D)(ii)(V) and 5 C.F.R. § 1320.5(a)(1)(iv), to publish a notice in the Federal Register "setting forth … an estimate of the burden that shall result from the collection of information." § 3506(c)(1)(A)(iv) and § 1320.8(a)(4) require that any burden estimate submitted to the OMB Director, including those under § 3507(d)(1)(A), be "objectively supported." For the types of burden in most procedural rules—*i.e.*, new requirements for content or form of papers—the only practical source of "objective support" for burden estimates is "conferring" with attorneys and other members of the public who do similar work. This set of critical path events requires consultation with the public sufficiently before the Notice of Proposed Rule Making to permit "objectively supported estimates" to be included with and supported in the NPRM and in the simultaneous submissions to OMB under the Paperwork Reduction Act.

This is all explained and reduced to a simple step-by-step timeline in my ABA Landslide article (see note 1) and the letter that has disappeared from the PTO's web site (see note 33).

[54] *Aqua Products, Inc. v. Matal*, 872 F.3d 1290, 1339, 124 USPQ2d 1257, 1287 (Fed. Cir. 2017) (Reyna, J. concurring).

646.472.9737 FAX 978.443.4812 | DBOUNDY@CAMBRIDGETECHLAW.COM | HTTP://WWW.CAMBRIDGETECHLAW.COM
686 MASSACHUSETTS AVE., SUITE 201, CAMBRIDGE, MA 02139 | MAILING: P.O. BOX 590638, NEWTON, MA 02459

required by the Administrative Procedure Act, Information Quality Act, and E-Government Act? How did so many elements of this proposal slip through the analyses that should have been done (at least to a preliminary level, to get the dead-on-arrival issues fixed) under Executive Order 12,866, the Paperwork Reduction Act, and the Regulatory Flexibility Act? Private sector entities, when they lose a major case, reform their practices to prevent recurrence—what has the PTO done to prevent a recurrence of the 2009 continuations/claims/ IDS/*Markush*/appeal debacle, and the criticism of "end-running" of the law from the Federal Circuit in *Aqua Products*?[54]

Remarkably, when I've heard members of the Office of General Counsel speak on the issue, they say "We're just doing what we've always done."[55] If the law changes from time to time, and the PTO loses cases, why is that good enough?

The Knight memo (see § I.D) is a symptom of the problem—it appears to be more a document on a single-minded drive to reach a preordained conclusion and to brush aside concerns; it does not bear the indicia of a *bona fide* effort to advise a client or analyze a legal position:

- What lawyer opines on a brand-new statute without reading the legislative history? How did the PTO's Office of General Counsel "overlook" the *removal* of the phrase "notwithstanding the fee amounts established or charged thereunder," the addition of the word "only," the admonitions in the House report that fees shall "do no more than reasonably compensate," and that the § 41 fee schedule were to be used as a "reference point?"
- The Knight memo uses the phrase "encourage or discourage a particular service" which tells us that the author of this memo was aware of the IOAA and its case law, probably from Dr. Katznelson's comment letter.[56] Then why is there no mention of the IOAA or any IOAA case, let alone analysis?
- If one takes the cue from Dr. Katznelson and reads the IOAA cases cited in his letter, how can one avoid learning of the Supreme Court's and D.C. Circuit's concern that the executive branch not trench on Congress's constitutional taxing power? How could a lawyer avoid investigating, and avoid addressing the issue in a memorandum of law?

Would any private sector client be well advised to rely on a memorandum of law that fails to mention the key statute, apparently known to the author, that constrains the memo's conclusion? That doesn't mention a single case? And that neglects to mention or analyze two other issues that are far more relevant? If the PTO's fees are ever challenged in court, the Knight memo will be a factor in the court's evaluation of "arbitrary and capricious." The failure to even

---

[55] At the March 2014 IPO "PTO Day," Raul Tamayo from the Office of General Counsel was on a panel. During Q&A, an audience member asked about a recent law change, and how the PTO was implementing it. Mr. Tamayo, the person responsible for this law, answered, "We're just doing things the way we've always done them."

[56] See footnote 13; see also his article at footnote 6.

mention the relevant law would weigh in favor of a finding of "contrary to law." The odd balance in the memo, mentioning the keywords from the relevant legal issue without discussing the issue, might suggest agency *intent* to operate contrary to law, which in turn could expose the PTO to attorney fees.

In the private sector, a compliance department doesn't just prevent legal problems, compliance prevents embarrassment. Don't you think Wells Fargo wishes its lawyers had gotten muscularly involved much earlier, and that maybe the increased user fees and production counts generated through Wells Fargo's account origination scandal hurt the bank more than it helped? Translating to today's context, does the PTO have anyone that looks at agency regulatory proposals beforehand to make sure they comply with the law, and communicate the agency's commitment to the public interest? To make sure the agency's proposed action doesn't communicate the impression that agency is in lawless pursuit of user fees, carelessly venial, or just plain greedy?

To take one example, the attorney registration annual fee would raise (in round numbers) $5 million per year (the PTO's materials are fatally deficient, because they don't give any estimate). The public compliance costs are $40-$100 million per year (see § III.D). Why does the PTO think it's a good idea to raise revenue by creating costs that are about ten times larger? Did anyone in the PTO give a moment's thought to this? If so, why isn't that rationale in the fee-setting supporting materials? If not, doesn't this demonstrate the importance of the administrative law? The Paperwork Reduction Act and Executive Order 12,866 required the PTO to do a certain amount of analysis and public consultation before any public phase of rulemaking.[57] Did the PTO do this analysis and consultation, and benefit-cost analysis? The record suggests that none of this happened—or else that it did, the PTO realizes the cost to benefit imbalance, and went ahead anyway. Any analysis of the numbers makes the PTO look at best uninformed or uncaring about the public interest. The administrative law requires agencies to be fully cognizant of that public interest, and act in the public interest. The way the law achieves that goal is to require the agency to ask itself the relevant questions, and give a public explanation—that's the best way to ensure that the agency not only *does* act in the public interest, but create the *appearance* of acting in the public interest.

When the PTO doesn't have procedures in place to ensure compliance with public interest requirements, inevitably, in some cases, the PTO will act in a way that creates the appearance of lack of concern for that public interest. A competent and powerful compliance department would prevent this embarrassment.

## VII. Conclusion

Having been in-house counsel, I can assure PPAC that no private sector board could approve a private sector corporate action when the company gave only this level of disclosure,

---

[57] The step-by-step timeline in my 2011 letter explains this. See notes 33 and 53.

and had so clearly given so little thought to compliance issues. PPAC should remand, and insist on a do-over.

I hope that PPAC finds this letter helpful.

Very truly yours,

Attachments:

Attachment A: Ron D. Katznelson, *The U.S. Patent Office's Proposed Fees Under the America Invents Act—Part I: The Scope of the Office's Fee-Setting Authority*, 85 BNA PAT. TM & COPYRIGHT J. 206 (Dec. 7, 2012).

Bloomberg BNA BNA's Patent, Trademark & Copyright Journal®

Source: Patent, Trademark & Copyright Journal: News Archive > 2012 > 12/07/2012 > BNA Insights > The U.S. Patent Office's Proposed Fees Under the America Invents Act—Part I: The Scope of the Office's Fee-Setting Authority

**85 PTCJ 206**

***PATENTS***

*This two-part article addresses the Patent and Trademark Office's proposed new patent user fees. In Part I the author argues that the PTO can raise fees in accordance with its aggregate costs but lacks authority to set national patent policies, or to skew certain fees to discourage or encourage a particular service. The author also asserts that the America Invents Act does not vest with the PTO discretion to set the level of its operating reserve—a determination reserved solely for congressional appropriations. An upcoming Part II will address specific fees and their public policy implications, critique the PTO's costing methodology, and propose a simple approach for setting fees.*

## The U.S. Patent Office's Proposed Fees Under the America Invents Act—Part I: The Scope of the Office's Fee-Setting Authority

**By Ron D. Katznelson**

*Ron D. Katznelson is the president of Bi-Level Technologies, a signal processing technology startup company in Encinitas, Calif. He can be reached at ron@bileveltech.com.*

On Sept. 6, 2012, the U.S. Patent and Trademark Office (the "PTO" or the "Office") published a Notice of Proposed Rulemaking titled *Setting and Adjusting Patent Fees*, 77 Fed. Reg. 55,028 (Sept. 6, 2012) (84 PTCJ 794, 9/14/12). The NPRM proposes to set fees under the fee-setting authority in the Leahy-Smith America Invents Act of 2011. [1] There is a need to adequately fund the operation of the PTO, after years of being under-resourced. The Office has made substantial progress in reducing its backlog in the last few years. However, the Office must exercise care in its stewardship of the fee-setting process and not exceed its authority under the law. The following sections examine the legal scope of the Office's fee-setting authority.

[1] P.L. 112–29, 125 Stat. 284 (Sept 16, 2011) (82 PTCJ 681, 9/23/11). See Sections 10, 11 and 22.

### 1) Recovery of aggregate costs is the *only* purpose of the PTO's fee setting authority.

The operative text of the AIA is Section 10(a) (uncodified):

> (a) FEE SETTING.—
>
> (1) IN GENERAL.—The Director may set or adjust by rule any fee established, authorized, or charged under title 35, United States Code, or the Trademark Act of 1946 (15 U.S.C. 1051 et seq.), for any services performed by or materials furnished by, the Office, subject to paragraph (2).
>
> (2) FEES TO RECOVER COSTS.—Fees may be set or adjusted under paragraph (1) only to recover the aggregate estimated costs to the Office for processing, activities, services, and materials relating to patents (in the case of patent fees) and trademarks (in the case of trademark fees), including administrative costs of the Office with respect to such patent or trademark fees (as the case may be).

Section 10 of the AIA grants the PTO authority to adjust fees *only* to recover aggregate costs. Further, the Office must comply with other relevant law. For example, the Office must also consider the Independent Offices Appropriations

Act of 1952, 31 U.S.C. § 9701, the Antideficiency Act of 1982, 31 U.S.C. §1512, the Chief Financial Officers Act of 1990, 31 U.S.C. § 902, the Administrative Procedure Act, 5 U.S.C. § 551 et seq., the Regulatory Flexibility Act of 1980, 5 U.S.C. §601 et seq., the Paperwork Reduction Act of 1980, 44 U.S.C. § 3501 et seq, the limits on PTO authority set forth in 35 U.S.C. § 2, and the U.S. Constitution's delegation of taxing authority exclusively to Congress. Without express congressional delegated authority or waiver, the Office's fee setting authority must be exercised within *all* current law, not just the AIA. [2]

[2] *Federal Communications Commission v. Nextwave Personal Communications*, 537 U.S. 293, 305 (2003) ("when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." Internal quotation and citations omitted).

### *1.1) Constitutional limits.*

Congress may delegate fee-setting authority to agencies, but that authority is limited by the Constitution's delegation of taxing authority to Congress. As discussed in Section 2.2 below, using fees to "encourage or discourage a particular activity" is a "tax" that requires an explicit delegation from Congress, a delegation that the PTO does not have.

### *1.2) The Independent Offices Appropriations Act (IOAA).*

Since 1952, agencies with fee-setting authority have been governed by the IOAA. If the PTO considered the IOAA in its rule making deliberations, there is no record of it. The opinion of the PTO's general counsel in support of the fee-setting rule and the rationales stated in the NPRM do not reflect the PTO's awareness of the statute or its associated case law. [3]

[3] *See* General Counsel Bernard J. Knight Jr., Memorandum, *USPTO Patent Fee Setting*, http://www.uspto.gov/about/offices/ogc/Fee_Setting_Opinion.pdf (Feb. 10, 2012) (silent on IOAA); NPRM (silent on IOAA).

The IOAA (31 U.S.C. §9701) provides as follows, in relevant part:

> (b) The head of each agency (except a mixed-ownership Government corporation) may prescribe regulations establishing the charge for a service or thing of value provided by the agency. Regulations prescribed by the heads of executive agencies are subject to policies prescribed by the President and shall be as uniform as practicable. Each charge shall be—
>
> (1) fair; and
>
> (2) based on—
>
> (A) the costs to the Government;
>
> (B) the value of the service or thing to the recipient;
>
> (C) public policy or interest served; and
>
> (D) other relevant facts.
>
> (c) This section does not affect a law of the United States—
>
> (1) prohibiting the determination and collection of charges and the disposition of those charges; and
>
> (2) prescribing bases for determining charges, but a charge may be redetermined under this section consistent with the prescribed bases.

Subsections (b)(2)(A-D) are written in the conjunctive and have been so construed by the courts. Following the Supreme Court's 1974 landmark decision in *National Cable Television Association Inc. v. United States* ("*NCTA*") [4] interpreting the IOAA, the U.S. Court of Appeals for the District of Columbia Circuit further interpreted the IOAA in several key opinions. As to the "cost to the Government" and the "value of the service or thing to the recipient," the D.C. Circuit explained "that the proper standard is not value *derived* by the recipient but rather value *conferred* on the recipient. In our view, this standard requires the fee assessed to bear a reasonable relationship to the *cost of the services rendered to identifiable recipients*" [5] (emphasis added).

[4] 415 U.S. 336 (1974).

[5] *Capital Cities Communications Inc. v. Federal Communications Commission*, 554 F.2d 1135, 1138 (D.C. Cir. 1976) ("*Capital Cities*"); *Seafarers International Union v. U.S. Coast Guard*, 81 F.3d 179, 185 and n.4 (D.C. Cir. 1996) ("*Seafarers*") ("the measure of fees is the cost to the government of providing the service, not the intrinsic value of the service to the recipient"). For a detailed discussion of the

court's construction of "value to the recipient" standard, *see National Association of Broadcasters v. Federal Communications Commission*, 554 F.2d 1118, 1130, n. 28 (D.C. Cir. 1976) ("*NAB*").

As to the IOAA's "public interest served" consideration, the D.C. Circuit explained that "[i]n *NCTA*, the [Supreme] Court invalidated the cable television annual fee because it charged cable operators a fee based in part upon 'public policy or interest served.' " [6] Although some language of the IOAA "appears to allow a fee [based on agency perception of 'public policy'], charging in part for an independent public interest served (rather than solely for value conferred upon the recipient) makes the assessment a tax rather than a fee." [7]

[6] *NAB*, 554 F.2d, at 1128, citing *NCTA*, 415 U.S. at 341.

[7] *NAB*, 554 F.2d, at 1128.

The D.C. Circuit observed that the Supreme Court "concluded that the IOAA must be narrowly read to prohibit this since there was no indication in the statute of an intent on the part of Congress to delegate the power to tax to the [agency]." [8] Rather, the IOAA's Subsections (b)(2)(C-D) identify considerations that require specific and express statutory authorizing language for agencies to encode policy through fees. Such language does not exist in the AIA.

[8] *NAB*, 554 F.2d, at 1128, citing *NCTA*, 415 U.S. at 342.

While Section 10 of the AIA authorizes the PTO to charge fees and generally recover aggregate costs, it makes no specific reference that sets aside the IOAA. The AIA Section 10(a)(1)(2) provides:

> Fees may be set or adjusted under paragraph (1) *only* to recover the aggregate estimated costs to the Office for *processing, activities, services, and materials* relating to patents [ ] including administrative costs of the Office *with respect to such patent* [ ] *fees* …. (emphasis added).

Thus, the plain language limits fee adjustments *only* for purposes of cost recovery. Moreover, the AIA's legislative history forbids the PTO from setting fees based on "the public interest served" or any "other relevant facts" except those explicitly delegated by Congress: it states that the AIA allows the PTO to set or adjust fees "so long as they *do no more* than reasonably compensate the Office for the services performed." [9] In setting fees not in accordance with the costs but for "public interest" purposes, the PTO seeks to *do more* than merely recover its aggregate costs—it seeks to implement through the fee structure policies which Congress did not intend. Neither the NPRM nor the PTO general counsel's opinion address these limitations.

[9] House Report 112–98, Part 1 (June 1, 2011), p. 49.

Because there is nothing in the AIA or its legislative history to compel a different result, the AIA must be regarded as being in pari materia with the IOAA—that is, statutes dealing with the same subject matter or having a common purpose—to be construed together as part of an overall statutory scheme. Where this principle applies, courts look to the body of law developed under the IOAA for guidance in construing the other statute. [10]

[10] U.S. General Accounting Office, *Principles of Federal Appropriations Law,* Vol. III, Ch. 12, pp. 172–174 (3rd Ed. Sep. 2008) (describing various agency-specific user fee statutes and collecting cases where those were treated by the courts in pari materia with the IOAA); *See also FCC v. Nextwave,* note 2 supra.

In fact, the AIA clarifies that the PTO's authority is precisely cabined within the IOAA. To the extent that the patent statutes "prescribe bases for determining charges" as contemplated by Subsection (c)(2) of the IOAA, these bases must be found explicitly in the statute.

### ***1.3) The PTO's proposed fee schedule.***

The NPRM details the key proposed fee changes and costs in Tables 4-36. [11] It then provides what it calls an "overall comparison" of patenting costs, but it does so in anecdotal cases, [12] arriving at meaningless conclusions such as "initial appeals fees decrease," when what matters is end-to-end costs.

[11] NPRM, at 55,039-57.

[12] NPRM, at 55,057-59.

The NPRM fails to account for the actual incidence rate for each fee item in patent applications and therefore fails to estimate the average fee increase for applicants. This is particularly important when one considers the radical fee increases proposed for claims, requests for continued examination (RCEs), and appeals.

When incident rates for all these are accounted for, a far different picture emerges.

Table 1 compares the average fees for large entities, demonstrating that the average fees for a patent application incurred before it issues or is abandoned (front-end fees) would increase by 42 percent. Because a smaller share of small-entity applicants tend to file RCEs or appeals (perhaps due to their limited financial resources), the average front-end fee increase they would incur under the PTO proposal is 38 percent (see Table 2.)

The strongest indication that the PTO is deviating materially from Congress's fee policies is the fact that it proposes percentage increases for the front-end fees that are *double* that of the increases in back-end fees, which are dominated by the maintenance fees.

Table 1. Proposed fee costs for average essential patenting activities (large entity).

| Fee Item | Average incidence per unit | Present fees set by AIA | | USPTO Proposed fees (NPRM) | | Large-Entity cost increase over that enacted in AIA |
|---|---|---|---|---|---|---|
| | | Large-Entity fee | Large-Entity average cost | Large-Entity fee | Large-Entity average cost | |
| | $u$ | $f_1$ | $f_1 \cdot u$ | $f_2$ | $f_2 \cdot u$ | |
| For filing, search & examination | 1 | $1,250 | $1,250 | $1,600 | $1,600 | 28% |
| For each independent claim in excess of 3 | 0.50 *a* | $250 | $125 | $420 | $210 | 68% |
| For each claim in excess of 20 total claims | 3.26 *a* | $60 | $195 | $80 | $261 | 33% |
| For a Request for Continued Examination | 0.55 *b* | $810 | $444 | $1,350 *g* | $739 | 67% |
| For an Appeal: | | | | | | |
| Filing Notice of Appeal | 0.120 *c* | $620 | $74 | $1,000 | $120 | |
| Filing an Appeal Brief | 0.078 *c* | $620 | $48 | | | |
| Filing an Appeal | 0.048 *d* | | | $2,000 | $96 | |
| Total for Appeals | | | $122 | | $216 | 77% |
| **Average Front-End Application fees** | | | **$2,136** | | **$3,025** | **42%** |
| Issue fee | 1 | $1,740 | $1,740 | $960 | $960 | -45% |
| Maintenance Fees: | | | | | | |
| At 3.5 years | 0.99 *e* | $1,130 | $1,123 | $1,600 | $1,590 | 42% |
| At 7.5 years | 0.71 *e* | $2,850 | $2,029 | $3,600 | $2,563 | 26% |
| At 11.5 years | 0.50 *e* | $4,730 | $2,365 | $7,400 | $3,700 | 56% |
| **Average Back-End Patent fees** | | | **$7,257** | | **$8,814** | **21%** |
| **Total Average patent fees** | | | **$9,394** | | **$11,839** | **26%** |

a. FY 2010 Fee Report, Appendix 1 to USPTO FY 2012 President's Budget, p. 139 ("Fee Report"). Number of excess claims is the ratio between the total fee collection for each fee category and the fee set for that category. Incidence is the number of Large-entity excess claims normalized by the number of all Large-entity UPR applications in FY 2010.

b. Fee Report, p. 140; Number of RCE filings is the ratio between the total fee collection for each fee category and the fee set for that category. Incidence is Large-entity RCE filings normalized by the number of all Large-entity UPR applications in FY 2010.

c. Fee Report p. 141 and USPTO Response to FOIA Request No. F-12-00105. Normalized by number of Large-Entity UPR applications in FY 2010.

d. FY 2010 appeal filings at BPAI at http://www.uspto.gov/ip/boards/bpai/stats/receipts/index.jsp. Normalized by Large-Entity share of appeals (note c) and the total number of UPR applications in FY 2010.

e. USPTO Ammual Report FY 2011, p.63. FY 2010 renewal rates.

g. RCE fee is average of first ($1200) and second or subsequent ($1700) RCE fees, weighted per usage rates of 70% and 30% respectively as published at 77 FR 55043.

Table 2. Proposed fee costs for average essential patenting activities (small and micro entities)

| Fee Item | Average incidence per unit | Present fees set by AIA | | USPTO Proposed fees (NPRM) | | | Small-Entity cost increase over that enacted in AIA | Micro-Entity cost increment over Small Entity cost enacted in AIA |
|---|---|---|---|---|---|---|---|---|
| | | Small Entity fee | Small Entity average cost | Small Entity fee | Small Entity average cost | Micro Entity average cost | | |
| | $u$ | $f_1$ | $f_1 \cdot u$ | $f_2$ | $f_2 \cdot u$ | $0.5 f_2 \cdot u$ | | |
| For filing, search & examination | 1 | $625 | $625 | $800 | $800 | $400 | 28% | -36% |
| For each independent claim in excess of 3 | 0.54 *a* | $125 | $68 | $210 | $114 | $57 | 68% | -16% |
| For each claim in excess of 20 total claims | 4.35 *a* | $30 | $131 | $40 | $174 | $87 | 33% | -33% |
| For a Request for Continued Examination | 0.30 *b* | $405 | $121 | $675 *g* | $202 | $101 | 67% | -17% |
| For an Appeal: | | | | | | | | |
| Filing Notice of Appeal | 0.072 *c* | $310 | $22 | $500 | $36 | $18 | | |
| Filing an Appeal Brief | 0.047 *c* | $310 | $15 | | | | | |
| Filing an Appeal | 0.029 *d* | | | $1,000 | $29 | $15 | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total for Appeals | | | $37 | $1,500 | $65 | $33 | 77% | -11.7% |
| **Average Front-End Application fees** | | | **$982** | | **$1,356** | **$678** | **38%** | **-31%** |
| Issue fee | 1 | $870 | $870 | $480 | $480 | $240 | -45% | -72% |
| Maintenance Fees: | | | | | | | | |
| At 3.5 years | 0.99 *e* | $565 | $562 | $800 | $795 | $398 | 42% | -29% |
| At 7.5 years | 0.71 *e* | $1,425 | $1,015 | $1,800 | $1,282 | $641 | 26% | -37% |
| At 11.5 years | 0.50 *e* | $2,365 | $1,183 | $3,700 | $1,850 | $925 | 56% | -22% |
| **Average Back-End Patent fees** | | | **$3,629** | | **$4,407** | **$2,203** | **21%** | **-39%** |
| **Total Average patent fees** | | | **$4,611** | | **$5,763** | **$2,881** | **25%** | **-38%** |

a. FY 2010 Fee Report, Appendix 1 to USPTO FY 2012 President's Budget, p. 139 ("Fee Report"). Number of excess claims is the ratio between the total fee collection for each fee category and the fee set for that category. Incidence is the number of small-entity excess claims normalized by the number of all small-entity UPR applications in FY 2010.
*b*. Fee Report, p. 139. Number of RCE fillings is the ratio between the total fee collection for each fee category and the fee set for that category. Incidence is small-entity RCE fillings normalized by the number of all small-entity UPR applications in FY 2010.
*c*. Fee Report, p. 141 and USPTO Response to FOIA Request No. F-12-00105. Normalized by number of Small-Entity UPR applications in FY 2010.
*d*. FY 2010 appeal filings at BPAI at http://www.uspto.gov/ip/boards/bpai/stats/receipts/index.jsp. Normalized by Small-Entity share of appeals (note c) and the total number of UPR applications in FY 2010.
*e*. USPTO Ammual Report FY 2011, p.63. FY 2010 renewal rates.
*g*. RCE fee is average of first ($600) and second or subsequent ($850) RCE fees, weighted per usage rates of 70% and 30% respectively as published at 77 FR 55043.

While the analysis in Table 1 and Table 2 does not include elasticity effects on filing and incident rates due to higher fees, it is indicative of the relative focus of the Office on increasing disproportionately fees that can suppress applicant filings for its own administrative convenience, rather than this nation's interests in securing inventors' rights.

So much for the Office's purported policy goal of "fostering innovation." The deference that the Office is entitled to, the significance of this point, and the public policies associated with the front- to back-end fee ratios will be discussed in Part II of this article.

**2) The PTO has neither power nor expertise to set policy for the nation's patent system.**

In an ambitious attempt to grab power reserved for Congress, the PTO asserts that the AIA "Section 10 authority includes *flexibility* to set individual fees in a way that furthers *key policy considerations*, while taking into account the cost of the respective services" [13] (emphasis added). Neither the AIA nor any other law contains a basis for this assertion.

[13] NPRM, at 55,028, emphasis added.

Yet, the NPRM further explains that in setting its proposed fee structure the PTO "considers three key *policy factors*: (1) fostering innovation; (2) facilitating effective administration of the patent system; and (3) offering patent prosecution options to applicants." [14] While these goals are laudable in the abstract, there is no law that empowers the PTO to set fees based on its own "policy factors."

[14] NPRM, at 55,033. See the PTO's accompanying discussion on these three "policy factors."

This proposed rule and its "policy" rationale are ultra vires. Rather, as shown below, Congress retained for itself the power to regulate and balance these policy factors.

Section 2(b)(2) of Title 35 empowers the PTO to "establish regulations, not inconsistent with law," for several enumerated purposes, *none of which include the broad policy factors* which the PTO claims to rely on in setting fees. While the Patent Act authorizes the PTO to promulgate rules governing "the conduct of proceedings in the Office" (Section 2(b)(2)(A)), it does not empower the Office to regulate the "administration of the *patent system.*" When Congress delegates authority to the PTO to exercise its discretion pursuant to public interests such as "the integrity of the *patent system*" it does so *explicitly* in statutes *specific* to certain proceedings (*see* AIA Section 6, 35 U.S.C. §§316(b), 326(b) governing inter partes and post grant reviews).

When Congress delegates authority to the PTO to act pursuant to public interests such as "fostering innovation," it does so *explicitly*, for example by providing for:

- 50 percent discount on small-entity fees (Act of 1982 Sections 1, 35 U.S.C. §§2(b)(2)(E) and 41(h)(1));
- 75 percent discount on micro-entity fees (AIA Section 10(g), adding 35 U.S.C. § 123);
- authority to refine the definition of "micro-entity" (AIA Section 10(g), codifying 35 U.S.C. §123(e));
- facilitate and expedite the processing of patent applications filed electronically (Section 2(b)(2)(C));
- a 75 percent discount on filing fee for electronic filing of applications (AIA Section 11, codifying 35 U.S.C. §41(h)(3));

- subsidy of application processing costs by authorizing post-grant charges for maintenance fees on issued patents (Act of 1982 Section 3(b), AIA Section 11, codifying 35 U.S.C. §4(b); maintenance fees set to recover 50 percent of patent processing costs. [15] );

- authority to expedite and examine out of turn patent applications that are important to the national economy or national competitiveness (AIA Section 25, adding 35 U.S.C. §§2(b)(2)(G)); and

- dissemination of patent publications to public libraries at low fees (Act of 1982 Section 3(d), codifying 35 U.S.C. §§11 and 41(d)(2)(B)).

---

[15] Pub. L. No. 96-517, 94 Stat 3015 (Dec. 12, 1980); *See* H. Rep. No. 96-1307(I), 8-9 (1980) (patent applicants should bear the Office's patent costs through the payment of fees split in equal amounts between application "processing" fees and post-grant "maintenance" fees). Prior to its taking effect, the 1980 law was amended by Pub. L. No. 97-247 on Aug. 27, 1982 ("Act of 1982"). To effect full user funding of PTO, the latter doubled both the patent processing and the maintenance fees from the levels authorized by Pub. L. No. 96-517, maintaining their relative proportions wherein each was intended to produce 50 percent of the Office's patent fee revenue. The increased new fees went into effect on Oct. 1, 1982.

---

When Congress delegates authority to the PTO to act pursuant to public interests such as increasing flexibility and "offering patent prosecution options to applicants," it does so *explicitly*, for example, by statutes providing for:

- authority to prioritize and examine out of turn patent applications upon payment of an additional fee (AIA Section 10(h));

- automatic extension of time (upon payment of a fee) for applicant's reply to an action on an application (Act of 1982 Section 5, AIA Section 11, codifying 35 U.S.C. §41 (a)(8));

- authority to refund fees on abandoned applications (AIA Section 11, codifying 35 U.S.C. §41(d)(1)(D));

- supplemental examination of issued patents (AIA Section 12, adding 35 U.S.C. §257);

- awarding a filing date even to applications submitted with missing parts (Act of 1982 Section 5, amending 35 U.S.C. §111);

- deeming any paper to be considered filed in the PTO when it is deposited in the U.S. Postal Service (Act of 1982 Section 12, amending 35 U.S.C. §21);

- ability to correct inventorship in an application with no prejudice (Act of 1982 Section 6(b), amending 35 U.S.C. §256); and

- revival of unintentionally abandoned applications (Act of 1982 Section 3(a), amending 35 U.S.C. §41(a)(7)).

Note that many of the public policy driven provisions listed above were enacted alongside significant fee legislation in the Act of 1982 and the AIA, indicating Congress's awareness of the inexorable connection between patent fees and the very public policy goals which the PTO claims to be within its regulatory dominion. Note also that when Congress does delegate to the PTO limited fee-based policy power, it does so under close supervision. [16]

---

[16] *See* AIA Section 10(g) codifying Section 123(e), requiring the PTO to inform the congressional judiciary committees at least three months before any PTO redefinition of "micro-entity" takes effect.

---

Congress has not intended the PTO to consider factors other than its aggregate costs of enumerated items. The PTO's seemingly constructive policy goals do not save its proposed fee schedule rule from being "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." [17]

---

[17] 5 U.S.C. §706(2)(A).

---

By making up its own policy goals not found in statute, the PTO's proposed fee structure is ultra vires and a prima facie arbitrary and capricious rule per se: "*Normally*, an agency rule would be arbitrary and capricious if the agency has *relied on factors which Congress has not intended it to consider*." [18]

[18] *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 43 (1983) ("*State Farm*") (emphasis added).

### *2.1) The PTO may not set fees to "encourage or discourage any particular service."*

Throughout the NPRM, the PTO notes that it proposes to set fees for purposes that include "facilitating the effective administration of the patent system"— a euphemism for fees set to affect applicants' behavior. Indeed, the NPRM explains that it would "help the Office to effectively administer the patent system by encouraging applicants to engage in certain activities." [19]

[19] NPRM, at 55,054.

For example, fees for independent claims in excess of three are increased by 68 percent—not based on cost to the PTO—but "to facilitate the prompt conclusion of prosecution of an application." [20] Despite proposing one of the steepest fee increases, the Office provides no cost data related to claim fees in its costing methodology document [21] and admits that for claim fees, "the PTO does not typically maintain historical cost information separate from that included in the average overall cost of activities during patent prosecution." [22] Indeed, the NPRM admits that these are "fees that will not be set using cost data." [23]

[20] NPRM, at 55,030.

[21] PTO, *USPTO Section 10 Fee Setting—ActivityBased Information and Costing Methodology* (Sept. 6, 2012), at www.uspto.gov/aia_implementation/aia_section_10_cost_supplement.pdf.

[22] NPRM, at 55,054.

[23] NPRM, at 55,040-41.

Noting that 30 percent of RCEs are *second and subsequent* RCEs, the NPRM proposes to increase fees for such applications by 83 percent and posits without any factual support that "[t]hose applications that cannot be completed with the first RCE do not facilitate an effective administration of the patent system with the prompt conclusion of patent prosecution." [24] It therefore concludes that "[s]etting the second and subsequent RCE fees higher than the fee for the first RCE helps to recover costs for activities that strain the patent system" [25] —clearly indicating that the higher fee is set to discourage this particular service on no basis other than a non sequitur assertion that a second RCE prolongs prosecution of an application.

[24] NPRM, at 55,043.

[25] NPRM, at 55,043.

As to these PTO policy goals, the PTO general counsel's opinion states: "While Section 41 authorizes setting fees to recover costs of individual services, Section 10 authorizes setting fees for a broad range of services to recover *aggregate* costs" [26] (emphasis in original). The opinion then leaps to an incredible inference: "Section 10 thus permits any individual patent fee to be set or adjusted so as *to encourage or discourage any particular service*, so long as the aggregate revenues for all patent fees match the total costs of the Patent operation" [27] (emphasis added).

[26] PTO General Counsel's Opinion, p. 3.

[27] *USPTO Patent Fee Setting Opinion*, Memorandum of Bernard J. Knight Jr., General Counsel (Feb. 10, 2012), p. 4, at http://www.uspto.gov/aia_implementation/fee_setting_opinion.pdf.

This conclusion undergirds the NPRM's fee structure under the Office's ultra vires efforts to promulgate patent policy rules that are "not in accordance with law" and therefore unlikely to withstand judicial review.

### *2.2) The IOAA forbids agencies from exercising undelegated "policy" authority to deviate from cost-recovery or "value to the recipient."*

Under the IOAA, the PTO has no authority to adjust fees "to encourage or discourage a particular activity." [28] This is because fee charges set to achieve public interest *policy* goals are *taxes.* While "taxes that seek to influence conduct are nothing new," [29] the power to levy such taxes is reserved for Congress.

[28] *Seafarers,* 81 F.3d at 183 ("Such policy decisions, whereby an agency could, for example, adjust assessments to *encourage or discourage a particular activity*, would, according to the [Supreme] Court, 'carr[y] an agency far from its customary orbit' and infringe on Congress's exclusive power to levy taxes," citing *NCTA*, 415 U.S. at 341) (emphasis added).

[29] *National Federation of Independent Business v. Sebelius*, 567 U.S. __, 132 S. Ct. 2566, 2596 (2012).

The Supreme Court explained this in *NCTA* by noting that "[t]he lawmaker may, in the light of the 'public policy or interest served,' make the [tax] heavy if the lawmaker wants to discourage the activity; or it may make the levy light if a bounty is to be bestowed. ... Such assessments are in the nature of 'taxes' which under our constitutional regime are traditionally levied by Congress." [30] The PTO's proposed fee structure would therefore infringe "on Congress's exclusive power to levy taxes." [31]

[30] *NCTA*, 415 U.S. at 341.

[31] *Seafarers,* 81 F.3d at 183.

Rather, specific and express statutory authorizing language is required for agencies to encode public policy through fees. [32]

[32] *NAB*, 554 F.2d, at 1128, citing *NCTA*, 415 U.S. at 342.

### *2.3) The AIA does not waive constitutional or IOAA limits.*

The AIA provides no such express authority and in any event the statute and legislative history forbids the PTO from doing so: the statute permits the Office to set fees "*only* to recover the aggregate estimated costs to the Office" [33] and its accompanying House Report states that the AIA allows the PTO to set or adjust fees "so long as they *do no more* than reasonably compensate the PTO for the services performed." [34] In setting fees not in accordance with the costs but for purposes of discouraging certain filing activities, the PTO seeks to *do more* than merely recover its aggregate costs—it seeks to implement through the fee structure policies to suppress applicants' filings which Congress did not intend.

[33] AIA §10(a)(1)(2).

[34] H. Rep. No. 112–98, Part 1 (June 1, 2011), p. 49.

Had Congress wanted the PTO to set fees higher for applications that "do not facilitate an effective administration of the patent system" it would have done so. Rather, Congress has historically resisted dozens of legislative attempts for patent fee-setting schemes based on such arbitrary unsupportable judgments.

While space does not permit listing these attempts exhaustively here, a few examples spanning nearly two centuries include: recent times, when Congress refused to adopt PTO's proposed progressive fee increases in 2002; [35] more than half a century ago when the PTO proposed an excess claim fee for each claim above a total of five "to screen" a "deluge" of applications; [36] and as early as 1830, when Congress rejected an increase in patent fees to discourage filing of "meritless applications." [37]

[35] PTO, *21st Century Strategic Plan*, fee proposal to Congress (June 2002), FAQ at http://web.archive.org/web/20021005230103/http://www.uspto.gov/web/offices/com/strat2001/faq.htm#q53 ("fees for excess claims will be based on a highly progressive system aimed at *strictly limiting* applications containing very high numbers of claims. In order to prevent "end-runs" of the claims fees, high fees are also being imposed on *excess continuations* and on the submission of patentably indistinct claims." Emphasis added.) These proposed fees are compared to a subsequently-revised schedule at http://www.uspto.gov/web/offices/com/strat21/feeproposalcomparison.htm.

[36] Rejected a provision in H.R. 4983 proposing a $5 excess claim fee for each claim above a total of 5: *To Increase Certain Patent And Trademark Fees*, House of Representatives, Subcommittee No. 3 of the Committee on the Judiciary, 84th Cong., 1st Sess., statement of Robert C. Watson, Commissioner of Patents, p. 24 (June 3, 1955) ("A substantial fee is necessary to make certain that the Patent Office is not *deluged with applications which disclose and claim devices of little value*." Emphasis added.)

[37] *See* 6 *Gale & Seaton's Register of Debates in Congress* 377 (21st Cong., 1st Sess.1830).

The PTO has no authority to throttle its workload by suppressing incoming filing rates. Congress has specifically instructed the PTO how to deal with the workload of *all* application types and services to avoid the "strain" on its resources: in Section 10(a)(1)(2) of the AIA the Office is directed to set fees for major items in a manner that *recovers* its "aggregate estimated costs"; and Section 41(d)(2) provides that the PTO "*shall* establish fees for all other processing, services, or materials relating to patents … to *recover* the estimated average cost to the Office of such processing, services, or materials …."

When the PTO complies with these statutory directives for cost recovery and acquires the commensurate resources, there is no such thing as "activities that strain the patent system." In taking on a policy role not expressly specified in the statute, the PTO exceeds its authority under the AIA. The PTO does not possess plenary fee-setting authority simply because Congress has endowed it with *some* authority to set fees. [38]

[38] *Railway Labor Executives' Association v. National Mediation Board*, 29 F.3d 655, 670 (D.C. Cir. 1994) (en banc) (An agency does not "possess[ ] plenary authority to act within a given area simply because Congress has endowed it with some authority to act in that area.").

***2.4) The PTO has neither mandate nor agency expertise to determine the economically efficient levels for patent fees.***

One cannot presume the PTO to be a neutral disinterested policy balancer that can set fees at economically efficient levels, because it has often demonstrated having a prima facie conflict with its direct administrative stake in the outcome.

More importantly, as an agency with the sole task and mandate to determine *patentability* of applications it receives, the agency lacks the necessary information and expertise to determine *any* matters bearing on *infringement* of patents and the necessary measures applicants use for appropriating returns from inventions in ways that *secure investments* that "foster innovation." These include the scope, the number of claims, and the number of applications or RCEs *necessary* to obtain claims that *adequately* protect inventions in the market place.

The PTO lacks the information and expertise to determine what aspects of patent applications "do not facilitate an effective administration of the patent system." It lacks the institutional visibility into the invention development and financing process and thus lacks information and expertise required to balance the public interests that it purports to consider—"fostering innovation" and "facilitating effective administration of the patent system."

A result of this lack of expertise and the Office's disconnect from invention appropriation and patent valuation practices is its facially flawed analysis for the purported economic gain associated with its fee increase proposal. In its Regulatory Impact Analysis, [39] the PTO projects a resultant reduction of patent pendency that it believes will contribute an incremental net monetized benefit to patent stakeholders and society of nearly $7 billion for the period FY 2013 to FY 2017. [40]

[39] PTO, *Regulatory Impact Analysis—Setting and Adjusting Patent Fees in accordance with Section 10 of the Leahy-Smith America Invents Act*, Notice of Proposed Rulemaking, Appendix A (September 6, 2012) ("RIA"), at www.uspto.gov/aia_implementation/aia_section_10_ria_doc-omb_9-6-12.pdf.

[40] NPRM at 55,029; RIA at Appendix A, Tables A-1 and A-2.

The PTO explains that "[r]educing pendency increases the private value of a patent because the more quickly a patent is granted, the more quickly the holder can commercialize the innovation." [41]

[41] NPRM at 55,032.

Applying a discount rate to a purported earlier acquisition of the lump sum patent value, the Office then calculated the increase in patent value from the reduction in pendency under its proposed alternative relative to a set baseline. However, this analysis is predicated on counterfactual assumptions on the invention commercialization process and that the patent value is acquired and accrues to patentees *only after* patent grant.

If this analysis were credible, the PTO would have had very little trouble long ago in persuading Congress that a $7 billion return to the economy is worth much more than any other possible return on government investment of $1 billion that Congress diverted from the Office. While there are substantial benefits for reduced pendency, the market reality is that the major portion of patent value is normally accrued shortly after the *application filing date*—not the patent issue date.

Patent value is recognized in legal risk evaluation and company valuation computations long before allowance. For example, dramatic pre-money valuation changes specifically attributable to patent rights held by venture-backed startups occur mostly after the patent application filing dates and well before the grant dates. [42] Similar empirical evidence in specific industries for this major pre-grant value accrual is found in the biotechnology industry, [43] the software industry, [44] and the semiconductor industry. [45]

[42] C. Hãussler, D. Harhoff, and E. Müller, *To Be Financed or Not… —The Role of Patents for Venture Capital-Financing* (2012). ZEW—Centre for European Economic Research Discussion Paper No. 09-003. Available at http://dx.doi.org/10.2139/ssrn.1393725.

[43] J.A. Baum, B.S. Silverman, "Picking Winners or Building Them? Alliance, Intellectual, and Human Capital as Selection Criteria in Venture Financing and Performance of Biotechnology Start-Ups," 19 *Journal of Business Venturing*, 411-436 (2004).

[44] Iain M. Cockburn and Megan J. Macgarvie, "Patents, Thickets and the Financing of Early-Stage Firms: Evidence from the Software Industry," 18 *Journal of Economics & Management Strategy*, No. 3, 729–773 (Fall 2009).

[45] D.H. Hsu and R.H. Ziedonis, "Resources as Dual Sources of Advantage: Implications for Valuing Entrepreneurial-Firm Patents," *Management Department Working Paper* (Aug. 2012), at http://www-management.wharton.upenn.edu/hsu/inc/doc/papers/david-hsu-signaling.pdf.

Moreover, the PTO entirely ignored the value of applicants' provisional rights "to obtain a reasonable royalty from any person who, during the period beginning on the date of *publication of the application*" infringes a claim in the published patent application [46] —well before the patent issues, and ignored patent term adjustment that often creates value that *exceeds* any loss due to delayed issue.

[46] *See* 35 U.S.C. § 154(d).

By ignoring "an important aspect of the problem"—the major value of pending patent applications—the PTO calculates that pendency reduction by six months would result in an increase of private patent value of $1,700 to $2,600. [47] If only the lower range for this incremental value is conservatively assumed, one necessarily obtains an incremental private patent value of more than $7,000 for a pendency reduction of two years.

[47] RIA at 184.

If the PTO's estimate of incremental private patent value were reasonably within the correct range, the majority of applicants would find the Prioritized Examination track a bargain they could not refuse—for only $4,800 applicants get the two-year acceleration that the PTO values at upwards of $7,000. Yet, in FY 2012 only about 5,000 requests were made for Prioritized Examination of applications (*less than 1 percent* of those filed in the year). [48]

[48] PTO, Prioritized Examination Statistics, http://www.uspto.gov/patents/init_events/Track_One.jsp.

If only 1 percent of *actual* applicants regard a two-year reduction in pendency worth $4,800, then an estimate that the *average* applicant values it at over $7,000 is incredible fiction, or in dignified legal jargon, "arbitrary and capricious." This is because the agency "entirely failed to consider an important aspect of the problem [and] offered an explanation for its decision that runs counter to the evidence before the agency" [49] in its own statistical records.

[49] *State Farm,* 463 U.S. at 43.

**3) The AIA vests no discretion with the PTO to set fees based on its desired "operating reserve" level.**

The NPRM states that the PTO proposes to set its fees higher based, among other factors, on "*building* a three-month patent operating reserve by fiscal year 2017 to support a sustainable funding model." [50] It states the "additional revenue from the proposed fee schedule will also recover the aggregate cost of *building* a three-month patent operating reserve by FY 2017," [51] and that in order to achieve this estimated target, "small and micro entities would pay some higher fees than under some of the other alternatives considered." [52]

[50] NPRM at 55,030.

[51] NPRM at 55,028.

[52] NPRM at 55,073.

The PTO hastens to "assure" the public that under the discretion it purports to possess, it would be "reducing patent fees once the operating reserve reaches an optimal level" [53] —clearly admitting that these charges are to be borne only by an arbitrary subset of applicants only to *build* assets that bear no "reasonable relationship to the cost of the services rendered to identifiable recipients*.*" The AIA and the IOAA accord the PTO no discretion to set fees based on its desired level of an "operating reserve" because contrary to the PTO 'creative accounting' assertion, "building" the unobligated "reserve" is *not* a "cost."

[53] PTO, FY 2013 President's Budget, p. 9 (Feb. 13, 2012) ("FY13 Budget").

***3.1) Unobligated cash for PTO "operating reserve" is not a "cost" cognizable under the AIA or the IOAA.***

AIA Section 10(a)(1)(2) enumerates the only cost elements that the PTO may use for "the aggregate estimated costs to the Office." These are: "processing, activities, services, and materials relating to patents"—none of which are "costs" for building a reserve; and "administrative costs of the Office with respect to such patent [ ] fees"—none of which are "costs" for building a reserve. [54]

[54] FY13 Budget, at 8 (PTO admits that building a reserve is not an "administrative cost," by stating that the Office has worked to "identify options for setting patent fees to only recover the aggregate estimated cost of the patent operations, including *administrative costs* to the USPTO *and* a reasonable *operating reserve*" (emphasis added)).

The PTO explains that its proposed fees are based on known costs plus "an operating reserve for longterm financial stability to pay *for unknown costs* or offset revenue loss due to the fluctuation *in demand for service*." [55] This logic is perverse because when "demand for services" declines—a condition which reduces the work the Office must perform—the aggregate costs cannot increase.

[55] PTO, *Executive Summary: Patent Fee Proposal*, Submitted to the Patent Public Advisory Committee, p. 20 (Feb. 7, 2012), at www.uspto.gov/aia_implementation/fee_setting_-_ppac_hearing_executive_summary_7feb12.pdf#page=20.

The AIA specifically excludes "recovery" of costs that will never occur. Furthermore, "unknown costs" are by definition non-estimable and are therefore not cognizable as part of the "aggregate *estimated* costs to the Office" under the AIA. Finally, the IOAA "requires the fee assessed to bear a reasonable relationship to the cost of the services rendered *to identifiable recipients*" [56] —neither the particular services nor the recipients are identifiable here under unobligated reserve funds because the PTO admits that the "costs" are "unknown."

[56] *Capital Cities*, 554 F.2d at 1138 (emphasis added); *Seafarers*, 81 F.3d at 183 ("fees cannot be charged based on a perceived furthering of public policy goals if those fees are unrelated *to a specific service provided by the agency to an identifiable recipient*" (emphasis added)); Executive Office of the President, Office of Management and Budget, Circular A-25, User Charges, § 6 (revised 1993), at www.whitehouse.gov/omb/circulars_a025 ("A user charge, as described below, will be assessed against each *identifiable recipient* for special benefits derived from Federal activities beyond those received by the general public.").

The Patent Public Advisory Committee, with whom the PTO must consult prior to setting fees under the AIA, [57] recognized in its memorandum soliciting comment from the public that the "cost of building a patent operating reserve" is not cognizable under the AIA:

[57] AIA Section 10(d).

a. Should the USPTO maintain an operating reserve?

b. If "yes," do you believe it is reasonable for applicants to pay fees *above and beyond the fees needed to cover aggregate costs* to fund the operating reserve? [58] (emphasis added).

[58] Patent Public Advisory Committee, Memorandum—PPAC Questions for Fee Setting Hearings, p. 1 (Feb. 7, 2012) at www.uspto.gov/about/advisory/ppac/ppac_questions_for_fee_setting_hearing.pdf.

Whether reasonable or not, the AIA does not delegate to the PTO the statutory authority to charge "fees *above and beyond the fees needed to cover aggregate costs*" to the Office.

As seen in Table 3, it appears that the PTO uses the term "operating requirements" to describe its estimated operating costs and the term "Aggregate Cost Estimates" to include its "Planned Deposit in Operating Reserve." That the Office plans to charge for providing patent services more than its aggregate costs per application is evident in Table 3 from the fact that the Office is projected to dispose of more applications (production units) than it receives (working on more units and reducing the backlog from 634,000 to 358,000) while still having over $750 million left over in FY 2017—a reserve increase of $636 million.

Another troubling aspect of PTO cost accounting for purposes of setting fees is evident in Table 3—it results in significantly higher cost ("operating requirements" per PU) than that under the PTO's actual cost performance in FY 2011 and FY 2012. The NPRM does not disclose the cost components that went into the projected "operating requirements" or how the cost estimates it gave for individual services aggregate to those levels.

Table 3. PTO's financial projections based on its proposed fees.

| Item (Dollars in millions) (a) | FY 2011 | FY 2012 | FY 2013 | FY 2014 | FY 2015 | FY 2016 | FY 2017 |
|---|---|---|---|---|---|---|---|
| Planned "Operating Requirements" | | | $2,549 | $2,702 | $2,809 | $2,846 | $2,945 |
| Less Other Income | | | -18 | -18 | -18 | -18 | -18 |
| Net "Operating Requirements" | | | 2,531 | 2,684 | 2,791 | 2,828 | 2,927 |
| Planned Deposit in Operating Reserve | | | 73 | 200 | 143 | 125 | 95 |
| Total Aggregate "Cost Estimate" | | | 2,604 | 2,884 | 2,934 | 2,953 | 3,022 |
| Aggregate Revenue Estimate | | | 2,604 | 2,884 | 2,934 | 2,953 | 3,022 |
| Target Operating Reserve | | | 637 | 676 | 702 | 712 | 736 |
| Operating Reserve Ending Balance | | 121 | 194 | 394 | 537 | 662 | 757 |
| **Utility, plant, and reissue (UPR)** | (c) | | (b) | | | | |
| Applications filed | 506,924 | 533,308 | 565,300 | 599,200 | 632,200 | 666,900 | 700,300 |
| Production Units (PU) | 508,549 | 548,051 | 620,600 | 671,900 | 694,200 | 645,200 | 656,200 |
| End of Year Backlog | 690,967 | 633,812 | 529,100 | 421,600 | 329,500 | 328,400 | 358,000 |
| Examination Capacity (Year-end) | 6,690 | 7,831 | 8,700 | 8,600 | 8,300 | 8,300 | 8,200 |
| **Ratios:** | (c) | | | | | | |
| Average Examination capacity in FY | 6,409 | 7,261 | 8,266 | 8,650 | 8,450 | 8,300 | 8,250 |
| PU per Examiner | 79.3 | 75.5 | 75.1 | 77.7 | 82.2 | 77.7 | 79.5 |
| "Operating requirement" per PU | $3,594 | $3,617 | $4,078 | $3,995 | $4,020 | $4,383 | $4,461 |
| Aggregate "cost estimate" per PU | | | $4,196 | $4,292 | $4,226 | $4,577 | $4,605 |
| "Operating requirement" per examiner | | | $306,213 | $310,289 | $330,296 | $340,723 | $354,788 |
| Aggregate "cost estimate" per examiner | | | $315,044 | $333,410 | $347,219 | $355,783 | $366,303 |

(a) - Table 3, NPRM at 55035; (b) - Table 2, NPRM at 55034; (c) USPTO Annual Report FY 2012, "Op. Req."/PU from p. 19.

In any event, the PTO is not precluded from establishing an operating reserve from fees it collects (and receives through congressional appropriations) that are based solely on aggregate costs cognizable under the law. However, it must establish such reserve in accordance with law, as explained below.

***3.2) The Antideficiency Act and the IOAA restrict the PTO's authority to accumulate an "operating reserve" as contingent outlays for meeting its liabilities; accordingly a reserve can only be funded and appropriated from the Office's unearned revenue.***

As the *Budgetary Reserve* section of the U.S. Government Accountability Office's publication on standard terms, definitions, and classifications states, "Except as specifically provided by law, no reserves shall be established other than as authorized under the Antideficiency Act (31 U.S.C. §1512)." [59] The Antideficiency Act arises out of tussles between Congress and the president over the power of the purse. The Act, in Sections 1512 and 1517(a), requires executive branch agencies to either spend monies appropriated for the year appropriated, or else to give Congress a specific explanation and accounting for held-over funds. If an agency wants to build a reserve, the reserve must be *apportioned* (that is, held in a specific account under specific procedures) *out only of funds appropriated* by Congress. This Act provides in pertinent part in 31 U.S.C. § 1512(c) as follows:

[59] GAO, *A Glossary of Terms Used in the Federal Budget Process* (5th ed.), GAO-05-734SP, p. 25 (September 2005).

> (1) In apportioning or reapportioning an appropriation, a reserve may be established only—
>
> (A) to provide for contingencies;
>
> (B) to achieve savings made possible by or through changes in requirements or greater efficiency of operations; or
>
> (C) as specifically provided by law.
>
> (2) A reserve established under this subsection may be changed as necessary to carry out the scope and objectives of the appropriation concerned. When an official designated in section 1513 of this title to make apportionments decides that an amount reserved will not be required to carry out the objectives and scope of the appropriation concerned, the official shall recommend the rescission of the amount in the way provided in chapter 11 of this title for appropriation requests. Reserves established under this section shall be reported to Congress as provided in the Impoundment Control Act of 1974 (2 U.S.C. 681 et seq.).

Thus, the Antideficiency Act in Section 1512(c)(1)(A) permits the PTO to build an "operating reserve" "to provide for contingencies" which the PTO contemplated, *but only from funds previously appropriated* by Congress. The PTO has no legal authority to *build* an operating reserve through self-help.

If the PTO wants an operating reserve, it must ask for an appropriation, and must "apportion" it using statutory procedures.

The Office seeks an "operating reserve" sufficient to continue to provide patent services for a period of three months in the event that the revenue stream is disrupted. Because the First Office Action backlog is much longer than three months, in this event, the PTO would be spending the reserve on *older* applications for which fees have been previously collected as *unearned revenue*. [60]

[60] Unearned revenue represents fees that have been received by the PTO for requested services that have not been substantially completed. This includes patent applications in the backlog for which the PTO has already collected upfront processing fees. As of FY 2012 end, the unearned patent revenue was $765 million. *See* PTO, FY 2012 Annual Report, at 99.

But the IOAA requires that fee revenue from identifiable applicants—applicants whose applications are drawn from the backlog—be used to provide services to those applicants, not from *higher* fee charges on new applications. The PTO must therefore seek congressional appropriations from the unearned revenue accounts to fund any reserve to be expended on the backlog.

### ***3.3.) The PTO undermines Congress's statutory scheme for establishing a reserve.***

Congress enacted a particular approach for establishing a reserve for the PTO and for examining the backlog. Two reserve mechanisms were established: the first is "Patent and Trademark Office Appropriation Account in the Treasury of the United States" created by 35 U.S.C. § 42(b). When applicants pay fees, and Congress does not appropriate those fees to the PTO's use, those fees accumulate in the Section 42(b) account. However, Congress has not appropriated all of that money—roughly $1 billion is nominally held at this Treasury account, but cannot be expended by the PTO because of "fee diversion" over the last two decades. The AIA makes no change here—Section 42(b) still withholds the PTO's authority to spend the money it collects unless and until Congress appropriates it. The second reserve mechanism is provided in the AIA: Section 22 added Section 42(c)(2) as follows (emphasis added):

> There is established in the Treasury a Patent and Trademark Fee Reserve Fund. If fee collections by the Patent and Trademark Office for a fiscal year exceed the amount appropriated to the Office for that fiscal year, fees collected in excess of the appropriated amount shall be deposited in the Patent and Trademark Fee Reserve Fund. *To the extent and in the amounts provided in appropriations Acts*, amounts in the Fund shall be made available until expended only for obligation and expenditure by the Office in accordance with paragraph (3).

Here too, the AIA does not empower the PTO to increase its "operating reserve" with funds, unless those funds are first appropriated by Congress. Second, Congress envisioned accumulation of reserves solely based on increases in filings beyond projections, resulting in fee collections for additional workload.

The money thus deposited in the Patent and Trademark Fee Reserve Fund is unearned revenue from which Congress can appropriate funds for any PTO "operational reserve." The level of the reserve established in Section 42(c)(2) is derived from the degree of volatility in fee collection compared to projections wherein the reserve is used to average *over time* upward and downward fluctuations in fee collections to match the costs to the Office.

This approach is consistent with the GAO's view of the principles that the PTO should employ in establishing its operating reserve [61] and with PTO's prior years' practice by mere change of terminology. Prior to FY 2010, the PTO called "unobligated balance brought forward" what it now calls an "operating reserve." It reserved a portion of the amount Congress made available annually through appropriations as a designated unobligated balance, which could be carried over for use in future years. This is possible because the PTO is generally appropriated no-year funds—with no fiscal year limitation, wherein the pertinent appropriating statute provides that the funds "shall be made available until expended."

[61] GAO, *Patent and Trademark Office: User Fee Review*, p. 8, GAO-12-514R (April 25, 2012) ("an operating reserve is important for fee-funded programs to match fee collections to average program costs *over time* and because program costs do not necessarily decline with a drop in fee collections" (emphasis added)).

The PTO can make compelling presentations to Congress and recommend particular levels of reserves to be appropriated from unearned revenues in the Section 42(b) account and the Patent and Trademark Fee Reserve Fund. However, it is clear that under the AIA, Congress *reserved for itself that decision* and the PTO has no authority to set its reserve levels.

Congressional intent as to the appropriate level of PTO "operating reserves" was made quite clear during last year's appropriation process when the House Committee on Appropriations recommended PTO's reserve appropriations remain at a low percentage of its annual budget:

> *Carryover funds*.—The Committee is concerned that the PTO has established an operating reserve whereby it intends to carry over funds from one fiscal year to the next as a ''cushion.'' For fiscal year 2012, PTO has proposed an operating reserve to help the agency maintain its pace of activities in years when fee collections diminish or fall below projections or during years of planned spending above collections. While some level of carryover may be advisable, the PTO is proposing to have an operating reserve of $342,470,000 at the end of fiscal year 2012. The Committee believes that given the backlog and pendency rates, *holding nearly 13 percent of its budget as a reserve into the next fiscal year is not a good management practice for an agency that is so far behind in whittling down its workload*." Accordingly, the PTO, in consultation with the Secretary of Commerce, is directed to propose in its fiscal year 2013 budget submission an exhibit stating specifically what the PTO intends to fund using carryover balances. [62]

[62] H. Rep. No. 112–169 (July 20, 2011), at 17 (emphasis added).

It is remarkable that right after Congress expresses reservations regarding the PTO's planned reserve of 1/8 of its annual budget and requests identification of specific obligations to be funded by the reserve, the PTO now plans to build a reserve that *doubles* that fraction to 1/4 of its annual budget for "unknown" obligations.

That the reserve cannot be a "cost" component in the PTO's fees is also clear from the basic fact that its level is subject to congressional determination—an appropriation determination that has no effect on the "aggregated estimated costs to the Office." Consequently, the PTO's theory clearly leads to an absurd result, which it neglected to address in the NPRM: the Office would have to reduce its fees when Congress refuses to accept its proposed reserve levels.

It appears, however, that through this proposed fee rule which "camouflages" the reserve within every dollar of fee collections, the PTO is attempting to evade congressional control over budgetary reserve levels as codified in the AIA. The PTO's camouflage attempt is transparent and therefore its proposed "operating reserve" is hostage to the same fee diversion that has constrained the PTO in the past.

The only legal remedy for establishing adequate reserves and avoiding the backlog that arose out of fee diversion is for Congress to restore the fees it failed to appropriate. This author has worked, and will continue to work hard to achieve this goal.

###

To be continued



ISSN 1522-4325