

Judiciary Committee Testimony

Hearing On The United States Patent & Trademark Office

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■ Introduction & PPAC Background:

Good Morning. Chairman Conyers, Ranking Member Smith, members of the Committee, it is my great pleasure to be here today on behalf of the Patent Public Advisory Committee of the United States Patent & Trademark Office, often referred to as the "PPAC". My name is Damon Matteo, and I am Chairman of the PPAC.

As you may be aware, the PPAC was established by this Committee (via 35 U.S.C. §5) just over 10 years ago as part of the American Inventors Protection Act. PPAC is comprised of nine members representing a broad range of constituencies (IP practice, industry/manufacturing, research & development, academia, and individual inventors) and are appointed to three year terms by the Secretary of Commerce. As part of our service in PPAC, we "review the policies, goals, performance, budget and user fees of the USPTO with respect to patents" and prepare an annual report on these matters that is submitted to this Committee, in addition to the Secretary of Commerce and the President.

■ Summary:

I am particularly grateful for this opportunity as this testimony comes at a pivotal time, one of transitions in the world economy, the innovation eco-system, the intellectual property landscape and at the USPTO itself. And now, perhaps more than ever, we find all of these factors linked and essential in achieving economic success. Yet, a key link in that chain, the USPTO, currently faces serious funding and infrastructure challenges that threaten its progress on several important initiatives, including improving patent quality and reducing pendency.

Challenges inevitably create opportunity, ours is to ensure and enhance the U.S. patent system's ability to support U.S. innovation and economic success. PPAC is dedicated to achieving the promise this opportunity holds, and to working collaboratively in support of the U.S. innovation economy, which by its nature embraces and reflects the interests of small inventors, large corporations, academia, R&D and patent practitioners.

Under Secretary of Commerce and Director of The United States Patent & Trademark Office, David J. Kappos inherited an organization challenged by funding, infrastructure, process and human capital issues, among others. In order to address these challenges, keep the USPTO the premier intellectual property office in the world and enhance its operations, a series of high-level issues need to be addressed. PPAC fully supports these high level objectives of the USPTO and recommends focused efforts and measured objectives for:

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- ♦ **Pendency & Backlog Reduction** – As a first step, we understand the USPTO is targeting ten month pendency to first action on the merits (2014), twenty months total pendency (2015), as well as shrinking the overall backlog which currently stands at approximately 700,000 applications.
- ♦ **Patent Quality** – Improving the quality of the patent product and attendant patenting process (information, search, duration, work-flow, etc...) is key in providing greater certainty around the timing, scope and validity of patents.

Just as addressing issues like Pendency and Quality support the plan to make the USPTO an exemplary intellectual property office, so too do these objectives require the support of appropriate resourcing and infrastructure capabilities. Long-term underfunding and legacy strategic decisions have left many of these enabling resources in short supply or in disrepair. PPAC sees the following resources and tools as among the most important employed in service of the USPTO's objectives, and those upon which I would like to focus in my testimony:

- ♦ **Budget & Fee-Setting Authority** – Recognizing that the USPTO is facing continued budget shortfalls arising from both the residual impact of the economic downturn and constraints imposed by the limited financial tools at its disposal, PPAC supports the prudent application of several approaches to remedy the situation.
 - **Fee-Setting Authority:** The first is to give the USPTO temporary administrative fee-setting authority to better accommodate funding needs, and also to better align costs and incentives with fees. PPAC believes this fee-setting authority must remain consistent with both the mission of the USPTO to foster and facilitate innovation as well as support the restored and enhanced operations of the USPTO. Setting the bounds of fee-setting authority, both in its duration and the scope of fees (perhaps as a function of percentage increases, aggregate percentage of operating revenue, etc...) with possible oversight or guidance by Congress and/or PPAC may be one way to ensure both objectives are best served.
 - **Fee-Diversion:** PPAC also supports legislation to permanently end fee diversion and/or earmarks that sideline USPTO revenues that should be directed at its operations. The applicant and patent holder communities are also likely to expect their fees to be directed at supporting the services they receive, not some other government programs – in particular given the current financial hardships of the USPTO.
 - **Financial Modeling & Tools:** In addition, PPAC encourages the USPTO to employ and expand its modeling of revenue and operational scenarios with an emphasis on identifying priorities as well as contingency planning to support and inform optimal strategy development and tactical execution. This expertise can also be employed in establishing appropriate fee-setting parameters. PPAC also supports allowing the USPTO to employ more flexible financial tools like establishing operating reserves.
- ♦ **Infrastructure** – Extended periods of inadequate funding and strategic neglect have left many of the USPTO's information technology and computer systems aging, unstable and barely adequate to support the tasks at hand. PPAC sees investment (and provision of attendant incremental funding) in this infrastructure on the critical path to supporting success in support of the USPTO's objectives. PPAC further endorses the USPTO's new efforts to fundamentally revisit the architecture of its IT infrastructure to capture performance and efficiency gains.
- ♦ **Process** – As a thread that runs through and binds many of the USPTO's other initiatives, process understanding and optimization should figure prominently in the USPTO's going-forward plans to achieve efficiencies and to increase productivity and quality. A particular instance of this is the 3% year-over-year efficiency gains the USPTO projects it will capture. Accordingly, PPAC continues to feel the still vacant Chief Process Improvement Officer ("CPIO") position and attendant process

understanding/optimization exercises are crucial to the USPTO fully realizing the benefits from many of its other initiatives.

- ♦ **Organizational & Hiring** – At the core of any organization are its people, culture and work processes. PPAC encourages the USPTO to continue and expand its efforts to align hiring, retention and training with requisite skills, to explore new ways to embrace a truly nation-wide workforce, and to foster a culture that inspires and rewards performance and initiative.

As Quality and Pendency are already both rather visible and broadly accepted goals, I would like to spend much of my time commenting upon the requisites for success in achieving these important objectives – in particular those most closely aligned with the direct impact of Congressional authority: budget & fees. By way of a cautionary preamble, however, PPAC is ever conscious of the interplay between the many linked aspects of USPTO operation, and encourages diligence to ensure that visibly articulated goals, such as Pendency reduction, not be accomplished by reducing the quality of the final product, or at the expense of other equally worthy objectives of the USPTO. That said, let me share some of PPAC's thoughts and observations on the operations, challenges, and opportunities now facing the US Patent & Trademark Office:

■ Budget & Fees

Background: As you know, the USPTO derives its entire budgetary authority from anticipated user fees. The decline of patent application and maintenance fee renewal rates experienced during the recent economic recession highlighted a vulnerability in the overall approach to funding the USPTO. The current fee structure establishes relatively low filing fees to encourage entry into the patent process, with the cost of examination heavily subsidized by downstream patent issuance and maintenance fees. So, the issue is two-fold: the cost of rendering the actual services does not correlate with the attendant fee, and changes in the business climate leave the USPTO open to large and unanticipated swings in revenue collection – with few, if any, meaningful financial tools at their disposal to deal with these revenue shortfalls. The USPTO ended FY 2009 with patent fee collections approximately \$170 million less than estimated in the FY 2009 President's Budget. In response to the FY 2009 decline in fee revenues the USPTO implemented almost \$200 million in budget reductions and cost-savings measures, slowing progress on important initiatives and further neglecting its aging infrastructure.

In addition to the vulnerabilities there is the effect of legacy budgetary shortfalls that over time impact infrastructure and other mission critical resources. So, in a very real way, the USPTO is playing catch-up at the same time it is forging ahead with new and important initiatives – including Quality and Pendency initiatives. Reliable access to these resources, improved infrastructure and funding are inextricably bound up in the success of the USPTO success in realizing many of its new goals.

Fee-Diversion: Given the import of both the level of, and visibility into, funding for the USPTO, PPAC firmly believes that the fees paid by patent holders and applicants for USPTO services should remain at the USPTO to support and enhance its operations. PPAC, and we believe much of the patent community, are alarmed to hear that in fiscal year 2010, up to \$230 million in USPTO fee collections may be diverted from USPTO operations. The USPTO originally requested, via the President's budget in February 2009, \$1.930 billion for fiscal year 2010. In September, 2009, the USPTO updated the Appropriations Committee with a new fee collection estimate of \$1.877 billion and at the same time, renewed its request for up to \$100 million in additional spending authority should the USPTO collect more than \$1.877 billion – a \$100 million "buffer", so to speak. Congress eventually enacted the budget at the \$1.877 billion figure but did not provide the \$100 million buffer.

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It is our understanding that the Congressional Budget Office ("CBO") actually projected that the USPTO would collect \$1.980 billion in fiscal year 2010. So, the Appropriations Committee was able to give the USPTO a number that matched the USPTO's estimate while at the same time the overall appropriations "pot" reflected the higher CBO estimate, thus giving Congress the difference between the two figures to spend on other government and programs. The USPTO is seeking legislation to provide use of the additional user fees it is now projecting to collect in fiscal year 2010, and is being told it must find an offset for the "new spending" because in essence, these additional fee collections have already been allocated outside of the USPTO. While we profess to have only a rudimentary understanding of the specific mechanics of the federal budgeting process, it seems clear that USPTO is forecast to collect more money in user fees than they are currently permitted to spend in fiscal year 2010 to deliver their services. We believe the applicant and patent holder community at large would see this as sub-optimal – particularly in light of the challenges presented by the legacy effects of previous budget shortfalls and the promise of the new initiatives in process at the USPTO.

Accordingly, PPAC strongly recommends the enactment of legislation to permanently end the diversion of USPTO fee collections to other government functions. Now that fee collections are trending back up, the USPTO should be able to access the full amounts in order to execute against strategic priorities, hiring, improve the IT infrastructure and pursue other initiatives necessary to for quality and timely processing of patent applications. A permanent end to diversion will provide the USPTO with the greater levels of certainty in planning that a performance based organization needs.

Fee-Setting: The current patent fee structure created in the 1980's established relatively low filing fees to encourage entry into the patent process, with the cost of examination heavily subsidized by issuance and maintenance fees paid by successful applicants who wish to maintain rights for the full patent term. Under current statutory authority, the USPTO is not at liberty to adjust its primary fees without legislation. This limits the USPTO's ability to adjust its fees in response to changes in market demand for patent services, processing costs, or other factors. We believe that to assure adequate funding levels for the long term, the USPTO needs authority to set and adjust fees administratively, so that it can properly establish and align fees in a timely, fair and consistent manner to recover the actual costs of USPTO operations and without going through the inherently long delays in the legislative process. This will afford the USPTO the opportunity to reform its funding model holistically to operate in a more businesslike fashion. After a period of time, or once the USPTO is on firmer fiscal footing, the fee-setting authority can be revisited.

We recommend providing the USPTO with temporary (time-delimited) authority to administratively set and adjust patent fees to more accurately reflect the actual costs of providing services to applicants, and to institute structural incentives consistent with the goals and mission of the USPTO. This may involve bounds set in advance for a range or aggregate of fees, potentially with advice or oversight by Congress and/or PPAC, and its success/direction/necessity should be revisited after a pre-determined time.

Financial Tools: PPAC believes that the USPTO should be given the tools needed to adjust for volatility in the economy and/or demand for its services without putting the USPTO in an operational crisis. Such tools should include the ability to establish and employ an operating reserve, and be directed at permitting the USPTO to reliably undertake long-term strategies for improvement in a financially reasonable way.

PPAC recommends exploring such financial tools, and providing the USPTO with fiscally responsible access to those mechanisms consistent with improving its operations, such as an operating reserve.

■ Infrastructure

Background: For some time, the IT infrastructure and attendant hardware and software systems at the USPTO have languished from a resourcing perspective (funding, human capital, upgrades *etc.*...) and also suffered from a lack of holistic strategic attention and execution. Over the course of eight years leading up to 2009, funding for the Office Of The Chief Information Officer ("OCIO") as a percentage of the total USPTO budget fell from approximately 21% in 2001 to about 12% of the total spending by the close of 2009. This reduction was the direct result of declining fee revenue, resulting in reduced spending throughout the USPTO.

The USPTO initiated the OCIO "Road Map" plan in 2008 to address the IT infrastructure needs and made the decisive move to fully support that effort with \$209.91 million incremental funding over five years. The Road Map initiatives focused on both the "remediation" of existing issues, but also forward-looking strategies for taking the USPTO into the next decade. Despite having a well considered and approved plan in place to effect this much needed remediation, declining fee revenues hampered progress on many aspects of the Road Map. In FY 2009, the OCIO took a \$66M reduction in funding *vis-à-vis* planned levels. To put this in perspective, one of the projects on hold was the Fire Suppression Upgrade in the Data Center putting the USPTO at risk that any fire regardless of scale (or even a false alarm) might render its Data Center completely inoperable, since the current fire suppression system is a water sprinkler system. Clearly this is not a sustainable situation – especially for an organization straining under legacy funding shortfalls. It is important to note that although it faced significant resource challenges, the OCIO was still able to make significant progress against its principal objectives.

PPAC is pleased to see that the USPTO recently began to roll out a fundamental architecture revisit of its IT infrastructure and brought in a Chief IT Strategy Officer to help guide this process. This process promises to replace the current architecture with a platform that can sustain and extend operations and capabilities well beyond what the current systems could support.

Summary Recommendations: PPAC recommends that any budget formulated for the USPTO contain sufficient incremental funding (or direct appropriation) for the USPTO to execute against the Road Map at its original five-year pace and pursue with all speed its new initiatives to re-architect the broader IT infrastructure. PPAC also recommends that the OCIO continue to explore and implement new technologies and business models in search of efficiencies and productivity gains e.g. external hosting and no-cost contracting.

■ Process Efficiencies & Effectiveness

Since its 2008 Annual Report, PPAC recognized the need for a process improvement at the USPTO and supported the USPTO's creation of the Chief Performance Improvement Office (CPIO). This need is only highlighted and amplified by the USPTO's recent announcement that it plans to achieve 3% year-over-year efficiency gains in its operations, and its recent Pendency objectives. Certainly, rigorous and empirically-based process improvement will play a pivotal role in achieving and sustaining these performance improvements.

The current situation has dictated a need, but also created the opportunity for the USPTO to explore and implement new business practices and models for achieving its goals e.g. no-cost contracts, external collaboration, outsourcing, *etc.*... to either complement and/or supplant internal efforts. PPAC also

encourages the USPTO to continue to develop objective measures and metrics to support and inform execution against these objectives, as well as progress against them.

Summary Recommendations: PPAC continues to believe that the USPTO must continue to elevate the effectiveness of its programs by implementing systematic and standardized evaluations in a consistent and proactive manner. To that end, PPAC makes the following specific recommendations:

- ♦ Take action to fill the permanent CPIO position and associated staff positions with highly qualified individuals as soon as possible.
- ♦ Press forward with full and effective deployment of the USPTO Strategic Management Process ("SMP") – facilitated by the CPIO – as a disciplined, fact-based process to drive sustained performance improvement through clear ownership and accountability coupled with effective decision-making and priority-setting.
- ♦ The PPAC encourages business process re-invention and experimentation by the USPTO in exploring new models, practices, capabilities and resources for achieving superior outcomes e.g. no-cost contracting, and improved "experimental design" for testing ideas and piloting new programs.

■ Quality:

It is critically important to patent applicants and the public that patents granted by the USPTO be of the highest quality and that decisions to allow or deny applications be conducted expeditiously. Although other measures of quality may prevail outside the USPTO, Quality is being defined for this purpose in terms of the likelihood that granted patents are of the proper scope, provide clear public notice, are likely to be upheld as valid by courts, and that those claims denied patent protection are affirmed on appeal – reducing both the issuance of invalid claims, and the rejection of valid claims.

The USPTO, in conjunction with the PPAC, is currently engaged in a data-driven Quality initiative to identify the measure and metrics of Quality that the USPTO can use internally, and its external constituencies can also use as objective indicia of quality.

PPAC recommends continued support of this Quality initiative, and the collaboration with PPAC in establishing objective measures that can be used to improve both the process and product of patent prosecution. In recognition to the interrelation of Quality and Pendency, however, PPAC cautions that improving patent quality in a manner that leads to increased application pendency is not a satisfactory solution.

■ Pendency

Patent applicants need to know as soon as possible whether their applications for a patent will be granted in order to make investment and product commercialization plans. Currently, average total pendency hovers over 34 months and pendency to first action on the merits ("FAOM") only slightly lower at just over 27 months. Pendency on that order has the potential to seriously diminish the value of patent protection itself, or in the worst case render patent protection meaningless. PPAC is pleased that Secretary Locke and Under Secretary Kappos have trained their sights on pendency. With what PPAC hopes is the first in a series of pendency objectives, the USPTO is targeting ten month pendency to first action on the merits (2014), and twenty months total pendency (2015), as well as shrinking the overall backlog currently at approximately 700,000 applications. In addition, there has been a substantial increase in requests for continuing

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examination (refiling of applications under 35 U.S.C. §120) and PPAC understands that this will be among the future Pendency phenomenon monitored and addressed by the USPTO.

PPAC supports and applauds these Pendency goals articulated by both the Department Of Commerce and the USPTO. These are significant and positive goals and will require substantial evaluation and modification of the current process. Further and again, PPAC urges Congress to provide the USPTO with ample funding (and authority) to ensure these goals are accomplished.

■ Closing Remarks

As I mentioned in my opening remarks, now is a pivotal time for the US Patent & Trademark Office. It faces many significant challenges, but is also poised to make significant progress against them. In our short time together, I've done my best to outline both the challenges and the requisites for success in meeting them from a PPAC perspective. I speak for all of PPAC in telling you that we stand ready to work with the USPTO, Congress and other institutions in any way that we can to help realize the goals of the USPTO and in service of the US innovation economy which we serve.

In closing, on behalf of myself and the entire Patent Public Advisory Committee, I would again like to express my appreciation for your kind attention to these important issues relating to the US Patent & Trademark Office. I would be delighted to answer any questions you might have, either now or in the future.

Thank you, once again!

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Note: For additional detail on these and other topics relevant to the USPTO, please see the Patent Public Advisory Committee's 2009 Annual Report, which may be found at:
http://www.uspto.gov/about/advisory/ppac/ppac_2009annualrpt.pdf