

Testimony
of
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The U.S.-China Economic & Security Review Commission

Hearing
On
Intellectual Property Rights Issues and
Dangers of Counterfeited Goods Imported Into the United States

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Co-Chairs and Members of the Commission:

Thank you for the opportunity to share my thoughts with you on the important question that you raise in your invitation – namely, *“How can the United States encourage the development of domestic technological and artistic innovation through the U.S. patent system?”*

The answer, in brief, is Congress should strengthen, not weaken, domestic patent protections. Accordingly, I urge this Commission advise Congress both to ignore several of the proposed “reforms” now being pressed upon it and also reverse several changes in U.S. patent law that it has made in the name of “reform” over the past decade and a half. The body of this testimony contains specific recommendations for proposed actions.

The New Competitiveness Challenge

As this and prior Commission hearings have documented in great detail, we are in the early stages of the greatest competitiveness challenge in U.S. history. In dozens of industries where the U.S. once stood alone as a technological innovator and global producer, Japan and Europe now dominate. Perhaps even more significant, the ancient economies of China, India and other Asian nations are

overcoming centuries of lethargy and quickly emerging as world-class innovators and producers.

Ultimately, the only way our nation can meet the economic challenge it faces is to vastly accelerate the pace at which it creates and applies new innovations. And central to that proposed effort is U.S. patent policy, which is the heart of U.S. technology policy.

For more than 205 years, U.S. patent policy has been distinguished by its strong protections for inventors. Until the mid-1990s, that policy guaranteed inventors quick decisions on their patent applications, 17 years of exclusive use regardless of how many months or years the USPTO took to evaluate an application, absolute secrecy about the contents of their patent applications until a patent was issued. Even if no patent was issued, the USPTO was obligated to keep secret the contents of the application, thereby allowing the applicant to use the creation as a trade secret. Patents went to the first-to-invent and could include as many claims as the innovator could prove. Most important, U.S. patent policy conferred not only strong patent rights, but also a means to defend them in the federal court system.

Perversely, however, beginning in the early 1990s, just at the moment the U.S. was being technologically and economic challenged as never before, the major U.S. business organizations, the largest corporations – along with the Governments of Europe and Japan – mounted a long-term effort to weaken U.S. patent protections. Their motivations are obvious – innovations and inventors not under their control are a direct threat to the status quo and to their positions. Major innovations, coupled with strong patent rights and the private means to defend them, are the very core of the “creative destruction” that Austrian economist Joseph Schumpeter found essential to a dynamic economy.

Weakening U.S. Patent Protections

Unfortunately, those who seek to weaken U.S. patent protections seem to have captured the attention of a majority in Congress. Unknowingly, Congress has enacted a series of changes in patent laws over the past decade that step-by-step are remaking the U.S. patent system into a mirror image of those in Japan and Europe – systems that are focused more on the social and collective management of innovation than its creation.

The vehicle for prompting these changes in the United States has been the WTO’s Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement. The

principal advocates for these changes are three global business organizations and their members:

1. The Business Roundtable which represents the largest U.S. corporations and banks;
2. UNICE, the Union of Industrial and Employers' Confederations of Europe, which represents business and industry from 22 European nations; and
3. The Keidanren, whose membership includes all major Japanese companies and industry associations.

The story of how these three business organizations persuaded their governments to adopt TRIPS and subsequently have been lobbying the U.S. Congress for changes in U.S. patent policy are documented in a series of articles and a book by Peter Drahos and John Braithwaite, two Australian scholars, and in my book, *Hot Property*.

The systemic weakening of the U.S. patent system is brought into sharp relief by a landmark study that was prepared by the General Accountability Office (GAO), **Intellectual Property Rights - US Companies' Patent Experiences in Japan** in 1993. The report captures in great detail, and at a specific moment (1992), the salient characteristics of both the U.S. and Japanese patent systems. The transformation of the U.S. patent system since then has been dramatic.

GAO researchers interviewed Japanese patent officials and lawyers, and they surveyed 300 foreign corporations who were top patent holders in Japan. The respondents were the top U.S. patent holders in three sectors - chemicals, semiconductors, and biotechnology - and included 90 percent of the U.S. companies that were part of the top 200 U.S. patent holders in 1991. Almost half of these companies had 10,000 employees or more, 32 percent had between 501 and 10,000, and 19 percent had 500 or fewer. More than 90 percent of these respondents had also filed patent applications in Japan during the past five years, two-thirds held ten or more Japanese patents, and all were experienced international businesses. The majority of these respondents were also large enterprises, with 60 percent reporting sales of more than \$1 billion annually.

While the 300 responding companies had all the resources needed to hire the best advisor and lawyers and do whatever the Japanese required foreign businesses to do in Japan, two-thirds reported significant problems dealing with Japan's patent system. By contrast, only 25 percent said they had similar patent problems in Europe and 17 percent in the United States.

In great detail, the GAO study also revealed that, unlike the United States, which administered its patent system in a country-neutral manner, Japan's patent system was at once a defensive, offensive, and a strategic tool of national development. It was being used to (1) keep foreign goods out of Japan, (2) protect proprietary Japanese technology, (3) examine the inner workings of the best foreign technology and (4) acquire foreign patents under advantageous conditions.

The GAO concluded that key differences in patent policy between the U.S., Japan and Europe in 1992 were as follows:

- The United States awarded patents to the person who is the first-to-invent. Japan (and Europe) awarded patents to the first-to-file an application.
- The United States provided seventeen years of protection from the date it issues a patent, no matter how many years the USPTO took to process the application. Europe and Japan provided protection that ended twenty years after the filing date, despite how much time their patent offices consumed in the review process. If that examination took 7 years, the applicant got only 13 years of protection.
- United States patent applications were secret until the government granted a patent. Applications that did not merit a patent were kept secret, allowing the applicant to apply their innovation as a trade secret. Japan, and all other nations, published patent applications eighteen months after an application was filed, thereby destroying an inventor's chance to use that creation as a trade secret.
- The United States gave inventors a grace period of one year in which to file an application after they had shown their invention to the public and also imposed no restrictions on the ways originators may reveal their inventions. Europe and Japan gave inventors a grace period of six months for disclosure and limited the types of disclosures they could make without losing their right to a patent.
- The United States and Europe excluded third parties from the patent review process. The Japanese Patent Office allowed third parties, including rival companies, to participate in their patent reviews.
- The United States did not allow third party opposition during the patent review process. Japan allowed third parties to oppose a patent

application even before they granted an award. Europe allowed third party opposition but only after they granted a patent.

- The United States Patent Office automatically examined every patent application filed. Europe allowed patent applicants to defer examination for up to six months. Japan allowed patent applicants to defer examination for up to seven years.
- The United States accepted patent applications in all languages. Europe accepted applications in the languages of nation party to the European Patent Convention. Japan accepted the patent applications in Japanese.
- The United States and Europe processed patent applications rapidly, generally in nineteen months or less. Japan processed patent applications slowly, generally in six to seven years.
- The United States' and Europe's scope of patent protection is wide, giving the inventor exclusive rights within a broad boundary of claims. Japan construed the scope of its patent protection as narrowly as possible.
- The United States and European legal systems eased the private enforcement of patent rights. Japan discouraged private action.

Most of the 300 corporate respondents to the GAO survey answered that they were unable to protect their intellectual property in Japan, and many also acknowledged that they were forced to enter cross-licensing and partnership deals with Japanese rivals that they would never have even considered in Europe or the United States.

If these large transnational corporations were unable to cope in Japan, then most individual inventors and small firms faced an almost impossible task.

In the intervening years, Japan has made some changes in its patent system. It has established a tribunal to hear patent cases, takes applications in English, hired more examiners and has lowered its pendency rate. Yet, its basic system remains unchanged. It uses the first-to-file approach, limits patent terms to 20 years, pre-publishes applications, and permits third party opposition.

In the same period, Congress has changed the U.S. patent system in two important ways.

1. It adopted the 20-year from application patent term.

2. It required the USPTO to publish patent applications 18 months after filing.

Now, Congress is being strongly lobbied by the advocates of a weak patent system to:

1. Adopt the Japanese and European practice of awarding patents to the first-to-file rather than the first-to-invent.
2. Permit third parties to participate in the patent review process.
3. Allow third party opposition during the patent review process.
4. Create a post-grant judicial procedure in which a patent can be more easily challenged than through litigation.
5. Eliminate the existing 18-month disclosure exemption for patent applications filed only in the United States and used by 10 percent of patent applicants.
6. Eliminate triple damage awards for willful patent infringement.

Moreover, the USPTO has taken public comment on a proposed rule on the practice of continuation that will further make the U.S. system like Japan's - a rule that will cut the number of a patent claims in an application. This will create great suffering for small entity inventors -- universities, biotechnology firms, emerging technology companies, small businesses and independent inventors - the people who file 45 percent of all U.S. patent applications. Currently, they can file a patent application and modify it as one's research progresses. Application and revision costs are borne by the applicant progressively and timely public disclosure occurs.

The proposed rules restrict the patent applicant to 10 claims and to 1 continuation absent special circumstances. This proposed rule change is so significant that it is something for Congress and not for the PTO to decide.

The "Patent Litigation Crisis" Claim

Advocates of legislation that would weaken U.S. patent rights justify such action on the claim that the United States is in the midst of a patent litigation "crisis" - a situation in which unprincipled patent holders are filing a massive number of lawsuits against established companies and thus are retarding the processes of innovation.

The data presented in the Federal Judicial Caseload Statistics for the period FY 2001-2005 reveal that no such crisis exists. In FY 2005, only 107 patent cases went

to trial in all the federal district courts. In FY 2004, the number was 86 and in FY 2003, it was 88. In FY 2002 it was 86. (Table 1 attached)

By no measure can 107 patent lawsuits going to trial be considered a litigation crisis, particularly in a nation that issued 165,000 patents in that same year.

Federal judicial caseload statistics for patent lawsuits and USPTO data on patent applications and patents issued reveal:

- An inventor is less likely to be involved in a patent suit today than in the past. The number of patent lawsuits filed per the number of patent applications filed has been on a downward slope since 1990.
- Likewise, the number of patent lawsuits filed per the number of patents granted by the USPTO had an even greater decline - almost 13 percent between 1988 and 2005.
- In the past five years, only 5/10,000 of one percent of patents issued were challenged in a patent trial.ⁱ
- In 2005, more than 30 percent of patent lawsuits settled with no court action required.ⁱⁱ
- In 2005, more than 53 percent of patent lawsuits settled before pretrial.ⁱⁱⁱ
- In 2005, more than 12 percent of patent lawsuits settled during or after pretrial.^{iv}
- In 2005, only 107 patent cases went to trial, which represents only 3.8 percent of all patent cases filed that year.^v

Put into context, the number of patent lawsuits that went to trial during the period 2001 to 2005 increased from 76 cases to 107 - hardly "explosive growth" in a judicial system that handled 260,000 newly filed cases that same year.

I conclude that the filing of a patent lawsuit is largely a tactic used in patent negotiations. The claim of crisis, I also conclude, comes from large corporations whose business model involves the aggressive taking and use of intellectual properties owned by others. These companies want access to the property of others without the liability now associated with their business model. They are asking Congress to give them a free pass card.

Foreign governments are lobbying Congress for weaker U.S. patent protections so their corporations can more easily appropriate those innovations.

Conclusion and Recommendations

Intellectual property policy is complex, esoteric and hardly the material of which political campaigns are made. Yet, it is vital to our national future.

The basic test for Congress on any proposed changes in patent law is whether it will strengthen U.S. patent protections. None of the proposals now being actively considered by Congress meet that test. All should be rejected.

In addition, Congress should be urged to enact legislation that assures inventors at least 17 years of patent protection, the historical U.S. standard. Ironically, the model for such legislation is the NAFTA enabling legislation. In that legislation, the patent term would be twenty years from the date of filing of a patent application or 17 years, whichever period is longer. Under the TRIPS minimum, an inventor whose application lingers 36 months or more actually has a shorter term of protection than in the past – a disincentive to invent and invest. Today, more technologically complex applications and those with breakthrough technologies often take 40 months or more before the USPTO makes a patent decision.

While the minimum term set by TRIPS as part of the World Trade Organization treaty is twenty years from filing, under WTO rules any nation can set a higher standard (as was done with the NAFTA treaty).

Unfortunately, “weak patent” advocates then persuaded Congress to adopt the TRIPS minimum term – twenty years from filing. The difference in term between the period set under the NAFTA pact and under the TRIPS minimum now in use is significant for the inventor and for the nation.

I also urge the Commission to again reiterate in its annual report to Congress the wisdom of canceling the 18-month rule, which forces the USPTO to put on the Net those patent applications that are unapproved 18 months after filing. This practice is making our best, most advanced technologies available to pirates and counterfeiters throughout the world at a moment the innovation has no patent protections.

Finally, intellectual property protection is a major unresolved issue in the U.S.-China relationship, one that has defied the usual policymaking and resolution processes. The Commission could potentially make a most useful contribution

by doing what no other organization has yet done – that is, convene a study group that is representative of the U.S. parties with a stake in this matter and come forth with some practical recommendations for the next Congress. The study group should include representatives from both the large corporations and the “small entity” inventor community (individuals, small companies with fewer than 500 workers, universities and non-profit organizations) – the people who file 45 percent of all U.S. patent applications. This group could be tasked with devising some consensus recommendations that this Commission could consider as part of its next set of recommendations for Congress. I believe that the work of such a group, bearing the imprimatur and insights from the Commission, could make a useful contribution in addressing this vexing issue.

Again, thank you for the invitation to join you today and share these thoughts. I look forward to your comments and questions.

Table 1

U.S. District Courts - Patent Cases Commenced and Terminated by Nature of Court Actions Taken, FY 2001-2005

Year	Cases Filed	No Court Action	Cases Terminated and Court Actions Taken			
			Total	Before Pretrial	During or After Pretrial	During/After Trial
2001	2520	634	1689	1330	283	76
2002	2700	665	1801	1413	302	86
2003	2814	673	1809	1372	349	88
2004	3075	769	1907	1432	379	96
2005	2720	863	1941	1492	342	107

Source: Federal Judicial Caseload Statistics, 2001-2005, Annual Statistical Reports, U.S. Courts. www.uscourts.gov/library/statisticalreport.html

Notes

ⁱ Calculated from data contained in **Federal Judicial Caseload Statistics, 2005**, Tables C-4 and C-2, and **USPTO Performance and Accountability Report: Fiscal Year 2005**, Table 1.

ⁱⁱ Calculated from data contained in **Federal Judicial Caseload Statistics, 2005**, Tables C-4 and C-2.

ⁱⁱⁱ *Ibid.*

^{iv} *Ibid.*

^v *Ibid.*