UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Productivity, Technology, and Innovation
Washington, D.C. 20230
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MEMORANDUM FOR Andy Manatos (Ann Tonjes)

FROM Jordan Baruch (David Guberman)

DATE 26 March 1980

SUBJECT Klutznick Patent Testimony: Answers to Questions of 21 March

Your memorandum to me of 21 March 1980 identified possible areas of questioning at the 3 April hearings on the President's industrial innovation patent proposals. This memorandum provides responses to the concerns expressed in each area.

--Concerns raised by Senator Long: To what extent are the problems raised by Senator Long, during Senate debate on S. 414, legitimate? How are these concerns addresed by the Administration bill? Why doesn't the Administration bill include a specific provision for recoupment? What is your opinion of the recoupment provision in S. 414 -- could the Administration support it or does the Administration have a proposed modification for it if the Congress so requests?

Senator Long is right to be concerned about the public's interest in the utilization of federally-financed inventions. His arguments against allowing contractors to obtain exclusive commercial rights, however, are not well-founded.

We are unaware of examples of contractors suppressing the use of inventions reported to the government to which they obtain exclusive commercial rights; in any case, the administration bill entitles the government to "march-in" to revoke those rights or compel licensing of others in the event a contractor fails to commercialize such an invention. In fact the greater danger is that, in the absence of the incentive provided by exclusive commercial rights, contractors will not be diligent in reporting federally-financed inventions to the government.

Senator Long used the physician who invented forceps for use in delivering children as an example of the evils of the patent monopoly. As the Senator noted, this physician kept the forceps a family secret for more than a generation. Senator Long properly condemned the unnecessary suffering to parents and children to whose physicians forceps were unknown and unavailable. This evil, however, has nothing to do with the

patent system generally or the administration bill in particular. Had the physician patented the forceps, the invention would have become public knowledge and his monopoly would have been limited in time -- in contrast, a trade secret, for example, the Coca-Cola formula, lasts as long as it is kept secret. Under the administration bill, the physician would have been able to protect his invention only by reporting it to the government and would have kept his commercial exclusivity only so long as he made the benefits of the invention available to the public on reasonable terms.

The administration bill is silent on recoupment because recoupment basically is a procurement, rather than a patent policy, issue and because the Office of Federal Procurement Policy currently is developing recoupment policies for the executive branch. Agencies already have, and in many cases exercise, recoupment authority.

The recoupment provision in S. 414 is defective in that it seeks to cover particular patents rather than inventions or technologies. Most products are likely to embody a large number of patents. When only some of the patents are federally-financed, determining what value is attributable to the government financing and what to the privately developed patents often will be an extraordinarily difficult and expensive process for contractor and the government alike. The administration would prefer to allow OFPP's work in the recoupment area to come to fruition and be allowed to operate before any final judgment was made. Of course, if the Congress determines that there should be a recoupment provision, the administration would want to work with it in developing specific language.

--Employee Inventor Rights: Why wasn't this issue addressed in the Administration's bill? Are you aware of previous Congressional proposals in this area? What is the administration's position on them?

The administration bill does provide for the allocation of rights in inventions made by federal employees according to the relationship of the invention to their employment and use of government resources. What the bill does not mandate is any particular policy with respect to private companies and their employees. Some legislative efforts have been made in this area in the past but have not succeeded.

First, this is not an element of federal patent policy and was not a part of the President's patent policy decision.

Second, it is far from clear that a uniform, mandatory policy is desirable in the private sector. One way for companies to compete with each other for qualified personnel, for example, is to offer more attractive compensation packages, and invention rights is only one kind of compensation.

Third, a mandatory invention rights policy may be inequitable. How is the government to say how much of a company's successful commercialization of a new product or process is owed to the employee whose name appears on the patent? how much to technical colleagues within the company? how much to marketing personnel? how much to others? No one can say, except perhaps on an ad hoc basis.

Fourth, employee invention rights really is a matter for contractual agreement between a company and its employees.

--Contracting and Licensing Functions: Does the Administration propose that patent licensing be done by the contracting agency or by a single agency? If one agency were to handle all patent licensing, would the Department of Commerce be the logical agency? What experience has the Commerce Department had with licensing patents. What experience have other agencies had with licensing patents? Can the Administration point to a record of success in the licensing of patents on a non-exclusive basis?

Under the administration bill, patent licensing could be done either by the contracting agency or by the Department of Commerce through our Center for the Utilization of Federal Technology in the National Technical Information Service. If it were desired to centralize the patent licensing effort, the Department of Commerce would be the logical agency because our knowledge of and contacts with industry cut across the particular technological areas of any single mission agency. Therefore, we would be able to maximize the utilization of commercially attractive inventions throughout industry.

NTIS's patent licensing efforts are comparatively recent. It markets patents referred to it by other government agencies. Since January 1979, NTIS has granted ten nonexclusive and two limited exclusive licenses. Nineteen nonexclusive and five limited exclusive licenses currently are under negotiation.

The experience of other government agencies is variable. Some, like NASA, have been more successful than others. There is general agreement among those involved that licensing patents on a nonexclusive basis ordinarily is tremendously difficult. There are some inventions, however, like instant mashed potatoes, which are so obviously commercially attractive or require little additional developmental effort in relation to the risk and potential profits that companies do not require commercial exclusivity.

--Industry use of new Technology: How do you respond to allegations that the patent system actually inhibits rather than enhances innovation? Isn't it in the industry's interest to fully utilize existing technology -- to maximize return on a previous investment -- rather than introducing new technology as soon as it is developed? If such a company retains title or an exclusive license in designated fields of use, wouldn't commercialization be delayed? Does the Commerce Department have the capability to determine whether a company is making reasonable efforts to commercialize an invention?

The profit incentive is a powerful spur to innovation. New products offer opportunities for increased sales and new processes can offer cost savings. Competition is another powerful spur to innovation. Especially when a company has proven something can be done by having itself made the invention, it would be dangerous risk competitor's stealing a march on it by not exploiting its own invention. Moreover, obtaining a patent results in the publication of technical information about the invention which adds to the usable store of knowledge. This may invite competitors to exploit an invention the inventing company might have preferred to delay developing. Thus, the allegation may have validity only with respect to a monopoly or leader in an oligopoly. Even there, the patent system offers protection and an incentive to new entrants and small firms. Absent patent protection, the giant firm probably easily and quickly could copy the new entrant's or small firm's innovation, and its economies of scale would drive the innovator from the field. This threat would discourage competitive innovation in the first place. The patent system enables the new entrant or small business to shield its innovation from the giant for a period of time which allows it to try to establish itself in the market.

In any event, the administration bill protects against non-commercialization through the march-in provision. The Commerce Department has the necessary expertise to determine whether or not reasonable commercialization efforts are being made. Moreover, the non-commercialization march-in is most likely to be considered on the request of a second company which is being denied access to the invention by the title holding small business or larger exclusive licensee. Thus, our determination will benefit from a development of the issues and the evidence by two adverse parties.

--Comparison of Administration proposals with Congressional legislation:

--What are the principal differences between the Administration's university and small business proposal and S. 414, introduced by Senator Bayh and H.R. 1414, as introduced by Chairman Rodino?

--What are the principal differences between the Administration's reexamination bill and the Bayh bill reported from the Senate Judiciary Committee?

S.414; H.R. 1414:

The principal difference between the Bayh-Dole bill and the administration bill is that the former is limited to a small part of the patent policy problem whereas the latter deals comprehensively with the entire problem. Specific differences based on review of the original version of S. 414 are noted below:

1. The Bayh-Dole bill provides a role for the Comptroller General in overseeing its implementation; the administration bill does not.

2. The Bayh-Dole bill limits nonprofit organizations in the ways they may exploit their inventions; the administration bill does not.

3. The Bayh-Dole bill contains a march-in right "necessary to alleviate health or safety needs which are not reasonably satisfied . . ." The administration bill does not because any situation qualifying under this march-in also qualify for a march-in on account of non-commercialization.

4. The administration bill contains march-in rights to protect the national security and to remedy violations of the antitrust laws; the Bayh-Dole bill does not.

5. The Bayh-Dole bill contains a recoupment provision; the administration bill does not.

6. The Bayh-Dole bill requires the federal government and title-holding small businesses and nonprofit organizations to give preferнce in licensing to companies promising to use the invention substantially in the United States. The administration bill does not because preferential legislation would be inconsistent with our efforts in connection with the multilateral trade negotiations to open foreign markets to United States goods and might provoke undesirable foreign reactions.

7. The Bayh-Dole bill requires the federal government to undertake a detailed and administratively burdensome consideration of any potential exclusive license of a federally-owned invention. The administration bill requires only that the licensing agency, after notice and an opportunity for filing written objections, determine that the desired practical application is unlikely to be achieved under a nonexclusive license and that the scope of the proposed exclusive license is not greater than reasonably necessary.

8. The Bayh-Dole bill requires the federal government to give preference to small businesses in licensing federally-owned inventions; the administration bill does not.

Patent Reexamination

The Bayh reexamination bill and the administration bill are substantially similar. The principal difference is that the Bayh bill would prohibit a party from relying in court on any reexaminable prior art which has not already been considered by the PTO unless the court concludes that the interests of justice would be furthered by not requiring reexamination. In addition, the Bayh bill mandates a stay of court proceedings to permit a party against whom a claim of infringement or patent invalidity is made to seek reexamination. The administration bill does not. [The Department of Justice would not accept a bill with any such provisions.] We expect that courts will want to take advantage of reexamination and will be responsive to requests to stay proceedings in order for reexamination to take place. However, the administration does not believe that trial judges should be ordeed to follow a particular course of action or that they should have to carry any special burden in deciding how best to manage the trial of cases before them.

--Enforcement: How does the Administration intend to enforce the march-in provisions?

Under the administration bill, contractors will be required to submit periodic reports on their commercialization activities to the responsible government agency -- either the contracting agency or the Commerce Department. In addition, private persons will be able to petition the responsible agency to exercise its march-in rights. With regard to non-commercialization and inventions whose use is required by federal regulation we expect the system to be largely self-enforcing. National security considerations would be the primary concern of the national security agencies. Antitrust considerations would be the primary concern of private persons and of the antitrust enforcement agencies.

--Increase in Red Tape: Won't your proposal for government licensing of inventions in those fields of use not identified by the contractor amount to a big increase in government bureaucracy at precisely the time we are trying to reduce it? What proof do you have that your proposal will work?

The administration proposal will reduce the existing administrative burden on both government and industry by substantially eliminating the case-by-case negotiations surrounding patent rights which are an inherent feature of the Kennedy-Nixon patent policy memoranda and such statutory schemes as NASA's and DoE's. An active licensing program by the government is intended. A major feature will be the evaluation of the commercial potential of the federally-owned rights. In the nature of things we cannot adduce proof that the proposal will work, although the NTIS and NASA experience is encouraging. The NTIS licensing effort, at least, is intended to be self-sustainig after an initial start-up period. If it is not, we would not want to continue it and would not expect OMB or the Congress to fund it.

--Second Look Provision: How do you respond to the industry allegation that the Administration's requirement for a second look is counterproductive to the purpose of the Administration's proposal? Won't the second look requirement cloud the certainty of the patent? Won't it discourage contractors from working with the Federal government?

The second look provision is discussed in the draft testimony for the Secretary. In brief, it reflects the existence of multiple, not entirely consistent, goals patent policy must try jointly to maximize. Uncertainty as to the exercise of the second look should be minimized because its

exercise is not mandatory, agency review is limited to unforeseen circumstances not known or reasonably knowable at the time of contracting, and the grounds for its exercise are limited -- requirements of agency mission; national security; antitrust laws.

--Relationship between Patent Policy and Trade Policy: Is the Commerce Department aware of the fact that the Japanese use government procurement ~~patent~~ policy as a trade barrier and, if so, what is the Departmentor the STR doing about it? (The reference is to Japanese policy which requires U.S. companies, after the sale of one or two products, to license the product for manufacture by Japanese companies).

Where the government is to retain title, how will companies operate in the Japanese market? Without title, they won't be able to livense as they do now, thus depriving them of revenue from licensing which is now available to them.

There is no Japanese policy such as the one mentioned. Japan, like most other countries, but unlike the United States, has a policy, sanctioned by the Paris Convention, which permits the compulsory, nonexclusive licensing of any invention which is patented within Japan but not worked within a certain period of time. The PTO, after consultation with industry, was unable to discover a recent case in which this right has been exercised. The last five requests for a compulsory license, all of which were rejected, were directed at patents held by Japanese.

The administration bill would permit small businesses and nonprofit organizations to obtain foreign patent rights. Other contractors also would have this right whenever the responsible agency determined that the national security interest would not be affected adversely. Where the government has title because the contractor did not want it, we could, with respect to inventions determined to have commercial potential, file a patent application ourselves and attempt to license its use.

--Effectiveness of existing NTIS: How do you respond to the allegations that NTIS has been a disaster for U.S. companies, particularly small businessmes, and a boon for foreign nations such as Germany, Japan and the Soviet Union? Is it true that these three countries computerize the information published by NTIS (which the U.S. does not do) and then feed it back in a systematic fashion to targetted industries who are then able to digest that information relevant to them?

Sales statistics show that NTIS information products are valued highly by American industry; universities; libraries; federal, state, and local agencies; and by small businesses. Annual sales now approximate $20 million. Domestic customers account for about 80 to 85 per cent of sales, by dollar volume. The NTIS master file lists over 100,000 customers; about 20,000 of these maintain deposit accounts for convenience in making frequent purchases. A substantial percentage of these customers are, or represent, small businesses. NTIS worked closely with the Small Business Administration in te past to make NTIS information products available to small businesses on a timely basis.

Documents sold by NTIS are prepared by or for the U.S. government; they are unclassified and in the public domain. In the case of the Soviet Union, however, the Assistant Secretary of Commerce for Productivity, Technology, and Innovation has directed NTIS to suspend sales to the U.S.S.R. and its known agents in conformity with the general policy behind the President's order to embargo the transfer of high technology to that country.

In answer to the computerization question, so far as NTIS is aware, foreign countries only purchase the computerized index to NTIS materials. This index is prepared by the U.S. government and equally available to American citizens.

--Computerization of the patent system: Why hasn't the Administration proposed to fully computerize the patent system? Wouldn't this be a preferable system to the current role of NTIS -- allowing a small businessman t secure the exact information he needs?

Computerization of the patent system has little to do with NTIS. It has everything to do with the utility and cost-effectiveness of a full-text retrieval computer system for the patent office files and patent examiner searches. As one of the President's industrial innovation initiatives, the PTO is working with an ongoing Defense Department computerization effort to determine feasibility. If, as we hope, the results are positive, then we intend to go forward with computerization of the system.

--Geneva negotiations: How do you account for the disastrous negotiations in Geneva and what plans do you have to ensure that future negotiations are sgnificantly more successful?

The Geneva negotiations over revision of the Paris Convention suffered from their proximity in space and time to UNIDO III which ended in some acrimony and unsuccessfully for the developing nations. Most of the developing nations were represented by the same people who attended UNIDO III. They then took a very hard line in the Paris Convention negotiations. Toward the end of the Geneva round, the developed countries' offers of compromise on some issues were met by the developing countries with an even harder line.

The issue which dominated the Geneva round concerned the requirements for adoption of revisions to the Paris Convention. Until now, unanimity has been required in recognition of each country's sovereignty and the cooperative nature of the industrial property protection enterprise. Subject to a reservation by the United States of its legal rights, the conference agreed to substitute for unanimity a procedure which will, for example, enable an expanded European Community to protect its interests but which will leave the United States, and countries with a similar legal system, unprotected.

The negotiation will resume next year with both sides working in the interim for more fruitful results. The venue may be a developing country, possibly Kenya.

LETS SELL

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S/K real prob = not competitive

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say $4 & $5 = Orig fees

Geo Hash

Tho Jeff

patents vital role to play

insert Thos Jeff & everyone else

* ask prior of augmenting statement

AM - don't you think we need 1 more session to go over Qs & As?

AMENDMENT NO._____ Ex._____ Calendar No._____

Purpose: Make various amendments to the bill

IN THE SENATE OF THE UNITED STATES-- 97th Cong., 2d Sess.

S. 1657
H.R._____ (or Treaty_____)
(short title)

(title) A bill entitled the "Uniform Science and Technology and Development Act".

( ) Referred to the Committee on _____ and ordered to be printed

( ) Ordered to lie on the table and to be printed

INTENDED to be proposed by Mr. Schmitt

Viz:

On page 28, line 21, insert "(1) immediately after "(c)"; on line 23, strike "(1)" and insert in lieu thereof "(A)"; and on page 29, line 11, strike "(2)" and insert in lieu thereof "(B)".

On page 29, insert the following immediately after line 16:

"(2) The license reserved to the United States under paragraph (1)(B) of this subsection may, if provided in the contract, include the right for the Government to require the contractor to license (or, if the contractor refuses, for the Government itself to license), pursuant to any existing or future treaty or agreement, any foreign government if the head of the

Federal agency determines at the time of contracting that the acquisition of such right would be in the national interest.

"(d) Technical data generated in performance of a contract and required to be submitted to the Government relating to a subject invention or to any product or process which includes a subject invention or relating to experimental, developmental or research work under a contract (as defined in section 103 of this Act) or relating to another agreement with the Government shall be the property of the contractor, subject to a free license in the Government for governmental purposes as specified in the contract, and, notwithstanding any other provision of law, together with other technical data submitted by the contractor, shall be exempt from mandatory public disclosure.".

On page 29, line 12, strike "section 301(a) of this title," and insert in lieu thereof "subsection (a) of this section,".

On page 36, strike lines 11 thru 21, and insert in lieu thereof the following:

"(B) striking, in section 306(a) thereof (42 U.S.C. 2458(a)), '(as defined by section 305)', and by striking 'the Inventions and Contributions Board, established under section 305 of this Act' and inserting in lieu thereof 'an Inventions and Contributions Board which shall be established by the Administrator within the Administration';".

"(C) striking the period at the end of section 203(c) thereof (42 U.S.C. 2473(c)) and inserting in lieu thereof a semi-colon, and by adding at the end thereof the following new paragraph:

'(14) to provide effective contractual provisions for the reporting of the results of the activities of the Administration, including full and complete technical reporting of any innovation made in the course of or under any contract of the Administration: Provided, That no reporting of inventions pursuant to this paragraph be in conflict with section 305 of the Uniform Science and Technology Research and Development Utilization Act or its implementing regulations;'".

"(D) striking, in section 203(c) thereof (42 U.S.C. 2473(c)), the following: '(including patents and rights thereunder)'; and

"(E) adding at the end of section 203 thereof (42 U.S.C. 2473) the following new subsection:

'(d) For the purposes of chapter 17 of title 35, United States Code, the Administration shall be considered a defense agency of the United States.'".

On page 39, line 14, strike "(iv)" and insert in lieu thereof "(iii)".