UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Legislative
and Intergovernmental Affairs
WASHINGTON, D.C. 20230

February 4, 2008

The Honorable Patrick J. Leahy
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510-6275

Dear Mr. Chairman:

This letter provides the views of the Administration on S. 1145, the "Patent Reform Act of 2007," as reported by the Senate Judiciary Committee on January 24, 2008.

The U.S. intellectual property system is the best in the world, and by some estimates, U.S. intellectual property (IP) is now valued at more than $5 trillion. Therefore, any changes intended to improve our nation's intellectual property system must be made carefully and thoughtfully. The Administration strongly supports passage of patent modernization legislation that fairly balances the interests of innovators across all industries and technologies by improving patent quality, which will reduce excessive patent litigation costs and promote certainty among patent holders and users.

The Administration continues to oppose Section 4, "Right of the Inventor to Obtain Damages." Consequently, we continue to oppose S. 1145 - in its entirety - unless Section 4 is significantly revised, as we believe the resulting harm to a reasonably well-functioning U.S. intellectual property system would outweigh all the bill's useful reforms. While well-intentioned, we do not believe a convincing basis has been established to justify the significant changes to current law in the bill's damages section. The Administration believes that it is important to provide greater certainty in patent litigation and remains interested in exploring options that do so. The requirements in Section 4 of the bill, as currently drafted, would likely lead to less than adequate compensation for many patent holders and could promote infringement. The Administration does not believe it advisable to create a statutory directive to courts that requires them to rigidly apply, in all cases, only one of the several broadly accepted factors now evaluated by the courts. At a time when we are actively encouraging our foreign trading partners to strengthen their IP protection and enforcement systems, this legislation may send the opposite signal – that we intend to weaken aspects of our current law that deter infringement.

While the current Section 4 damages language will create more problems than it solves, we believe that certain useful improvements could be made to the current law governing damages. We look forward to working with the Congress to find a compromise that spurs innovation and strengthens IP enforcement while deterring infringement. We believe an agreement can be reached that is beneficial to all concerned parties. However, without substantive changes that protect the inventor and deter infringement, we will continue to strongly oppose this legislation in its current form.

Opposition to Section 4, "Right of the Inventor to Obtain Damages."

We believe that the damages language in the bill's current version is unacceptable and will have a negative impact on most patentable innovations. Section 4 of S. 1145 limits the discretion of the Federal courts in determining how damages are calculated to compensate a patent holder for patent infringement. The Administration believes that such a dramatic change from current jurisprudence may have the unintended consequence of reducing the rewards of innovation and encouraging patent infringement. The U.S. patent system must preserve the incentive to innovate and continue to offer innovators the opportunity to be adequately compensated and recover their investments. Across all industries, most innovations are built on existing innovations. This progression of ideas has led to valuable inventions ranging from the light bulb to the airplane. The bill as written would undervalue such improvements.

By the time a Federal court addresses the issue of damages, it has already determined that the defendant has infringed a valid patent. The focus of Section 4 is how to determine appropriate compensation for the infringer's misappropriation of intellectual property. Section 4 seeks to address the perception that, in some instances, compensation for infringement may be too high. The language of Section 4 proposes to solve this concern by steering judges to specific methods of calculating damages, at the expense of other methods of calculation. Promoting an inflexible approach discourages more innovations and business models than it encourages.

The Administration believes that encouraging innovation within particular business models or technology sectors must not come at the expense of innovation in others. Innovation can and will be encouraged in all industries by giving Federal judges the flexibility to apply appropriate economic principles to the facts of each case, consistent with the business model or technology. To further ensure fairness in determining damages, judges should be given the explicit statutory authority and responsibility to identify all those factors the jury should consider in assessing damages and develop a sufficient evidentiary basis in the court record. The jury should likewise be required to apply all of those factors, and only those factors, in its assessment of damages.

For these reasons, the judiciary needs the flexibility to determine a reasonable royalty based on the circumstances of a particular case. Greater certainty is needed in patent litigation, but the language currently in S. 1145 is not the most effective way to create that certainty. The ambiguities introduced by the bill's proposed language will, in fact, increase uncertainty in how damages are determined or calculated. This uncertainty will take years to resolve in the courts, and could result in long-lasting uncertainty over the value of the Nation's stock of intellectual property. We believe that the risks to the patent system created by Section 4 are overwhelming.

The Administration welcomes the opportunity to work with the Congress to develop statutory clarification to preserve necessary judicial discretion, while directing the courts to identify the factors relevant to the determination of damages and limiting consideration to those factors. Such clarification could include language that provides courts with flexibility to consider all relevant factors in determining a reasonable royalty, and provide appropriate guidance to the courts as to when application of the entire market value rule and apportionment are appropriate. As a general matter, these provisions must be technology-neutral without favoring or injuring a particular industry.

Major Areas of Agreement

The Administration supports many provisions of S. 1145, with some qualifications.

Applicant Quality Submissions

An important goal of patent reform is to ensure that patents are properly issued and then respected once granted. Rather than emphasize changes at the end of the process (litigation), the Administration believes that American industry and innovation will benefit most from improvements at the beginning of the process (patent applications and examinations). Continuing to increase the quality of patents will promote certainty for both patent holders and patent users and should reduce the need to litigate.

The Administration strongly supports the bill's provisions to promote patent applicant quality submissions. As our patent system confronts increasingly complex technologies, it is critical that patent applications contain basic high-quality information as a requirement, not an option. Fundamentally, the quality of a patent begins with the patent application. We believe more high-quality information, in addition to quality-improvement initiatives currently underway, will lead to higher quality patents. Additionally, the *efficiency* of patent examination, including our ability to keep costs low, depends on quality patent applicant submissions. S. 1145 supports these imperatives with provisions for basic information requirements and inequitable conduct reform.

In recognition of the status of certain small businesses and independent inventors (micro-entities), we also have proposed and continue to support the bill's provisions to exempt smaller entities from the basic information requirements.

Finally, we appreciate S. 1145's inclusion of inequitable conduct reform language, but believe there is more to be done to ensure that patent applicants fully and fairly share relevant information with the United States Patent and Trademark Office (USPTO). The uncertain inequitable conduct standard in effect today actually deters applicants from sharing necessary information with the agency. This information can greatly accelerate the patent examination process and increase its quality. We are also concerned about sufficient sanctions for misconduct and that the bill's language continues to apply the vague "important to the reasonable examiner" standard for materiality, which has further inhibited disclosure. We would like to work with you on this provision to address these concerns.

Fee-Setting Authority for the USPTO

The Administration supports the bill's provisions giving the USPTO authority to adjust (eliminate, lower, consolidate, or raise) patent and trademark fees as needed to accurately recover the costs of providing services to innovators. Because the USPTO is a fee-funded agency, this ability would allow the agency to plan and respond appropriately to changing market needs.

The ability to adjust fees will also contribute to the operational stability of the USPTO, enabling the agency to take critical actions as needed. Major steps forward have been achieved in recent years. The USPTO has hired more than 1,000 new patent examiners annually for the past three years, developed an intensive patent examiner training academy, and implemented more quality and efficiency reviews. The USPTO helps strengthen IP rights and enforcement in the United

States and around the world by providing IP policy guidance, education, and initiatives to stop IP theft. This work is vital to the Administration's commitment to protecting America's IP.

S. 1145's provision granting the USPTO authority to adjust fees is consistent with the Administration's efforts to ensure that the USPTO has the flexibility to adjust to unforeseen developments.

Establishment of Post-Grant Patent Review Procedures

The Administration supports establishment of an effective, efficient post-grant patent review process that truly functions as a lower-cost alternative to litigation for those who want to challenge a patent's validity.

While we support the structural approach to post-grant review as outlined in S. 1145 (including having a first window of opportunity to challenge a patent within one year of grant, and having a second window throughout the patent life, triggered by a timely notice of infringement and threat of significant economic harm), we believe that improvements are required to make the bill's post-grant procedures more effective, efficient, and manageable. For example, the threshold standards for access to both the first and second-window challenges need to be clarified. Further, the efficiency of the procedures would be improved by applying the *estoppel* effect for first-window reviews to "issues actually raised," and to "issues that were or could have been raised" for second-window reviews. This will help protect patent holders against claims that are not raised in a timely and appropriate manner. Again, we would be pleased to work with you to draft such clarifications.

End of *inter partes* Reexamination

Similarly, the Administration supports this bill's provisions to end *inter partes* reexamination in favor of the new post-grant review procedures. Consistent with S. 1145, we also do not favor the assignment of *inter partes* reexamination to the USPTO's Board of Patent Appeals and Interferences, because the Board is an adjudicative body, separate and distinct in experience from a reexamination unit. And in general, we believe that any applied time frames should be considered carefully to ensure their successful implementation.

Other Areas of Disagreement

USPTO Funding

The Administration opposes the proposed language of the bill that would fund the USPTO through a mandatory revolving fund account as we believe it is unnecessary and would reduce oversight. Since 2005, the Administration has provided USPTO full access to its estimated fee collections. Additionally, the 2008 President's Budget proposed and the omnibus appropriations bill of 2007 enacted a provision giving the USPTO authority to spend up to $100 million more than estimated fee collections, if actual collections are higher than enacted estimates.

We believe that the omnibus provision, along with full access to estimated fee collections, provides the USPTO the necessary flexibility to enjoy access to all fee collections. It will also maintain annual appropriations oversight, which has inherent value in ensuring that fee collections are well-spent. As we have done in the past, we will continue to work with Congress

to ensure that the USPTO has the necessary flexibility to spend fee collections, while maintaining proper oversight.

Additional Comments

Finally, the Administration has comments on other provisions of S. 1145.

First-Inventor-to-File System
Although the Administration supports the bill's efforts to transition the United States to a first-inventor-to-file patent system, we would like to work with you to address technical issues regarding the scope and application of prior art and the grace period. Further, we believe that the effective date of the first-to-file provisions should be contingent upon a formal determination that specific progress and certain agreements have been reached in relevant international negotiations.

Check Collection
The Administration opposes the bill's provisions to limit remedies against financial institutions that use patented check collection systems, when such use would otherwise be patent infringement. Limiting patent holders' rights and remedies in this instance could reduce innovation in this technology area. As a general matter, the Administration does not support exceptions to patent protection based on a particular technology.

Late-Filing Acceptance Authority
Regarding the bill's grant of authority to the USPTO Director to accept late patent and trademark filings in certain cases of unintentional delay, we have not identified a need for such a provision. If this provision is adopted, it would be critical that the authority be limited in scope and applied prospectively for the USPTO to effectively administer it.

Technical Concerns
The Administration has several technical suggestions about the bill, such as recommendations on the inventor's oath and declaration, as well as concerns about the scope and application of several of the effective dates. Again, we look forward to sharing these suggestions with you for consideration.

Willful Patent Infringement
With respect to the bill's provisions on willful patent infringement, we were pleased that the Court of Appeals for the Federal Circuit, in re *Seagate Technology,* raised the standard for willfulness determinations. The Federal Circuit eliminated the "duty of care" and held that enhanced damages are only appropriate when the infringer acts with reckless disregard for the patent holder's rights. Because this decision is consistent with both the bill's intent and the Administration's views on the issue, the proposed statutory revisions in Section 4 are no longer necessary.

Conclusion

As this letter makes clear, we believe that improving quality at all phases of the patent lifecycle is crucial to ensuring high-quality patents that merit respect and reduce the likelihood of wasteful litigation. A robust intellectual property system is built upon and relies on fundamentals of predictability, clarity, timeliness, and fairness. Downstream litigation costs can be minimized through patent clarity – offered through such early elucidation mechanisms as applicant quality submissions and post-grant procedures. Flexibility in assessing damages ensures that results can be tailored, avoiding a "one-size-fits-all" approach that pleases no one.

We thank you for the opportunity to share our views on this important patent modernization legislation. We hope to continue working with you to improve the U.S. IP system, while maintaining the balance of interests among innovators across all industries, the American public at large, and the operational needs of the USPTO.

The Office of Management and Budget has advised that there is no objection to the transmittal of these views from the standpoint of the Administration's program. If you have any questions, please contact me or Robert Seidman, of my staff, at 202-482-3663.

Sincerely,

Nathaniel F. Wienecke

cc: All Members of the Senate Judiciary Committee