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Technology Law with a Business Perspective

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Via Email fee.setting@uspto.gov; ppac@uspto.gov

Brendan Hourigan, and Patent Public Advisory Committee
United States Patent and Trademark Office
Mail Stop CFO
P.O. Box 1450
Alexandria, VA 22313–1450

Re: Patent Public Advisory Committee Public Hearing on the Proposed Patent Fee Schedule, 83 Fed. Reg. 37487 (Aug. 1, 2018)

Dear Mr. Hourigan, Ms. Jenkins, and members to the Patent Public Advisory Committee:

My name is David Boundy. I am an intellectual property lawyer in Boston, and have expertise in administrative law that might be helpful to PPAC and the PTO. In early 2018, when the Federal Circuit was putting together speakers for the March 2018 Federal Circuit Judicial Conference, the court felt they needed education on administrative law topics and sought help from the most-knowledgeable people in the country. They called me to chair the panel. In the opening remarks for the day, Judge Plager told the court and assembled audience that one of my articles[1] would be very helpful to gain an understanding of administrative law. In 2008-09, I led teams that successfully urged the President's Office of Management and Budget (OMB) to quash the continuations/claims/IDS/ *Markush*/appeal rules. I wrote the first draft of several of the party briefs in the *Tafas v. Kappos* litigation, including the briefs that led the Federal Circuit to reinstate the district court decision below (vacating the 2007 rules in their entirety), and award Dr. Tafas his attorney fees against the PTO. Working behind the scenes, I've quashed several other PTO rules—I understand that my name was spoken loudly on the top floor of the PTO

[1] Judge Plager of the Federal Circuit also recently recommended an article as a very good primer on administrative law. David E. Boundy, *The PTAB is Not an Article III Court, Part 1: A Primer on Federal Agency Rulemaking*, American Bar Ass'n, Landslide, vol. 10 no. 2 (Nov-Dec 2017), available at https://www.americanbar.org/content/dam/aba/publications/landslide/2017-nov-dec/ptab-not-article-iii-court.authcheckdam.pdf or http://cambridgetechlaw.com/wp-content/uploads/2018/07/Boundy-The-PTAB-is-Not-an-Article-III-Court-Part-1-Primer-in-Federal-Agency-Rulemaking-ABA-Landslide-v-10-n-2-p-9.pdf .

several times during this period, when my behind-the-scenes work blocked several PTO rulemakings. Each of the rules I blocked were PTO attempts to reduce the agency's costs by shifting disproportionate costs to the public.

I write this letter to prevent that kind of thing from happening again—it's much easier and better to prevent those problems at the beginning of the process, than to fix them when the final rule text or MPEP is already at the printer. Despite the criticisms I offer in this letter, I am writing as a friend of the Patent Office. I care *deeply* about the health of the patent system. The PTO performs a crucial function, and when it does its job well, it's the best in the world. But every federal agency operates under legal constraints, and the laws are especially prescriptive around fee setting. The relevant laws are directed to important policy objectives: favorable benefit-cost ratios, sound analytical methods, constraining the natural tendency of federal agencies to regulate in their own interest rather than the public interest, recognizing the importance of small entities, entrepreneurship, and the like. Apparently the PTO is unaware of many of the laws that govern fee setting, and thus several of the PTO's proposals do not properly weight these public policy concerns.

Most of this letter is a primer in basic administrative law principles. Most of the administrative law is procedural. Like any other procedural law, these laws do not specify outcomes; they direct decision-makers to ask themselves certain questions, to introspect and analyze to ensure that the agency properly considers and weighs certain public policy concerns. The information made available to the public as of August 2018 does not reflect PTO compliance with that law, or agency understanding of the public policy concerns Congress and the Executive Office of the President directed agencies to consider. We all benefit when an agency follows all necessary procedures—various laws require agencies to conduct through benefit-cost analyses, so that the agency does not raise costs on the public by $2 to reduce its own costs by $1, doesn't raise fees to cover costs that ought to be reduced through better internal agency controls, touches the analytical points and neutrality guarantees set by the Office of Management and Budget (rather than the outcome-directed analyses that have accompanied past fee-setting), takes account of small entities using the analytical tools and methods provided by the Small Business Administration, considers paperwork burden and adaptive responses in applicant behavior that will tend to increase that burden, and the like.

I write to bring attention to the goals of the administrative law—the PTO has a crucial function to play, and can only serve the public interest well if the PTO takes these laws seriously, and asks itself the questions that the law directs.

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I. Two different laws clarify that the PTO may not use fee-setting as a policy lever to "encourage," "discourage," "incentivize," or "disincentivize"

The legislative history of the AIA makes abundantly clear that the PTO may not use fee-setting as a policy lever. Fee setting may be used ***only*** to recover aggregate costs. Likewise, the

United States Constitution denies agencies the authority to set fees for anything other than cost recovery—setting fee levels to "encourage or discourage" is a "tax," and agencies don't have authority to tax.

Assembling all the relevant laws yields the following algorithm that the PTO must use to set fees:

1. Start with the statutory fee numbers in 35 U.S.C. § 41(a), (b), (d), and (h). The PTO may increase all fees in proportional lockstep to a level that "recovers the aggregate estimated costs." Congress exercised its policy-setting authority when it embedded various cross-subsidy levels into § 41. Once Congress has done so, the PTO cannot raise one fee or lower another to incentivize or disincentivize applicant conduct, to "encourage innovation," or any of the other policy-based rationales stated in the 2018 materials or the 2012-13 rulemaking. This is discussed in §§ I.A and I.B.
2. For any processing activities that are not covered by the specific enumerated fees of § 41, the PTO may price the service at cost. (The PTO could reasonably interpret § 41(d)(2)(A) and similar statutes outside the specific fees scheduled in § 41 to include a proportional share of general and administrative costs.). This is discussed at § I.C. There are a few exceptions, including prioritized examination, IPR petitions, and PGR petitions, where the statutory language grants exemptions from cost recovery or the § 41 schedule.
3. The PTO has limited authority to break out of proportional lockstep, but only within the limits of the Constitution and other laws that apply to all other agencies. For example, the PTO may break out of the proportional lockstep where the PTO has specific line-item data showing that a specific line item's costs have risen at a rate faster or slower than general costs. In that case, the PTO could exercise the "cost of providing the service" authority of the IOAA to break that line item out of the proportional lockstep, by the degree of the faster or slower cost rise. There may be other breakouts from proportional lockstep, but I don't see them right now.
4. However, there are things the PTO can't do:
    - The PTO may not set fees to encourage or discourage any activity (see §§ I.A and I.B).
    - The PTO may not create new fees in areas already covered by § 41; new fees may be created only where the PTO has a specific statutory authorization (see § II.A)
    - The PTO may not set fees without a benefit-cost analysis—for example, the PTO may not reduce its own costs if that would increase costs on the public disproportionally (see III.C).

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The PTO's *Executive Summary* slide deck[2] explains four objectives. Mr. Hourigan described them as "Four key fee-setting policy factors."[3]

The following objectives have been established in support of this goal:
• Promote Administration innovation strategies
• Align fees with the full cost of products and services
• Set fees to facilitate the effective administration of the patent and trademark systems
• Offer application processing options

If it's "policy," it's not within the PTO's power to address by fees.[4] Bullet 2 is within the PTO's § 10 authority. Bullets 1 and 3 are not. Bullet 4 may be authorized when the PTO has a specific authorization such as § 2(b)(2)(G) (prioritization) or § 41(d)(2)(A) first sentence (requiring cost recovery and only cost recovery for services not otherwise covered in § 41), but not otherwise.

In several Notices of Proposed Rulemaking, and in the slide deck for this fee-setting proposal, the PTO concedes that fees are being set to incentivize, disincentivize, and to "set fees to facilitate the effective administration of the patent and trademark systems." That's not within the PTO's authority. It's contrary to statute, and unconstitutional.

A. The AIA legislative history is clear: PTO may set fees *only* to recover aggregate cost—Congress specifically *removed* any implication of authority to use fees as a policy lever

The relevant section of the AIA reads as follows (emphasis added):

> (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 b***y, 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).

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[2] PowerPoint slide deck, *PPAC Executive Summary*, https://www.uspto.gov/sites/default/files/documents/PPAC_Executive_Summary.pptx slide 3 (retrieved Aug. 12, 2018)

[3] Brendan Hourigan, speaking at PPAC hearing, https://livestream.com/accounts/4828334/events/8347855/videos/179904665 at 39:10

[4] The broadest grant of "policy" authority is in 35 U.S.C. § 2(a)(2)(A)—the Director has authority to "provide policy direction … for the Office" but not for the public or patent system.

Section 10 as originally introduced in 2011 read as follows (2011 Cong. Rec. Sen. S139-S140 (Jan. 25, 2011), see also version as presented for Senate floor debate, Cong. Rec., at S945 (Feb. 28, 2011) (emphasis added):

> SEC. 9. FEE SETTING AUTHORITY.
>
> (a) FEE SETTING.—
>
> (1) IN GENERAL.—The Director shall have authority to set or adjust by rule any fee established or charged by the Office under sections 41 and 376 of title 35, United States Code, or under section 31 of the Trademark Act of 1946 (15 U.S.C. 1113), ***or any other fee established or charged by the Office under any other provision of law***, ***notwithstanding the fee amounts established or charged thereunder***, for the filing or processing of any submission to, and for all other services performed by or materials furnished by, the Office, provided that patent and trademark fee amounts are in the aggregate set to recover the estimated cost to the Office for processing, activities, services and materials relating to patents and trademarks, respectively, including proportionate shares of the administrative costs of the Office.

Note that the January-through-March Senate version arguably allows the PTO to move fee income around as it likes, "notwithstanding the fee amounts established or charged [by § 41]," so long as "fee amounts are in the aggregate set to recover the estimated cost."

This language was slightly amended by Sen. Leahy's floor debate manager's amendment (Cong. Rec. at S950 (Feb. 28, 2011), and at S1037 (Mar. 1, 2011)), though the broad "notwithstanding" discretion remained in the bill through Senate passage on March 8, 2011 (Cong. Rec. S1389 (Mar. 8, 2011)).

When the bill moved to the House, as introduced by Rep. Smith, the bill had the final-passage language (H.R. Rep. No. 112-98, at 23 (Jun. 1, 2011)):

- The "notwithstanding" clause was removed
- The "any other provision of law" clause was removed
- The word "only" was added as a qualifier on "to recover the aggregate estimated costs"

The section-by-section in the House Report makes clear that these changes, and their effect, was fully intentional (H.R. Rep. No. 112-98, at 49-50) (emphasis added):

> *Fee-setting authority*
>
> **a) Agency fee setting authority**
>
> … The USPTO has argued for years that it must have fee-setting authority to administer properly the agency and its growing workload. The Act allows the USPTO to set or adjust all of its fees, including those related to patents and trademarks, ***so long as they do no more than reasonably compensate the USPTO for the services performed***.
>
> …

The House report continues, at page 78:

> *Section 11. Fees for patent services.*
>
> The Act includes the current patent fee schedule in the text [now § 41]. This schedule represents a reference point for any future adjustments to the fee schedule by the Director.

The addition of the word "only" was entirely intentional, and intended to remove the PTO's discretion to use fees as a policy lever to "incentivize" or "encourage"—the directive is not "the PTO shall charge no more than necessary to reasonably compensate," the language is that fees shall "***do no more than*** reasonably compensate." Likewise, the legislative history makes abundantly clear that the removal of the "***notwithstanding the fee amounts established or charged thereunder***" is entirely intentional, and is a directive to the PTO to track § 41 as a "reference point."

Both the January introduction and the September final-passage versions of the statute make clear that the PTO has discretion to include general and administrative fees in its user fee recovery base (unlike other agencies, see § I.C). However, the June House bill and its discussion in the House Report makes clear that the PTO has *only* that authority, and does *not* have discretion to use user fees as a policy lever.

B. The Constitution and the Supreme Court's definition of "tax"

The current proposal is a "tax," not a user fee. The Supreme Court and D.C. Circuit explain that the line between "taxes" and "user fees" lies with agency purpose. A "user fee" is a fee set for reasons of neutral cost-recovery. On the other hand, any fee set for any policy reason, "public interest," to "encourage or discourage a particular activity," etc. is a "tax." The PTO overstepped its authority in 2013, and propagates the error in this fee-setting proposal.

The AIA *does* waive a statutory constraint that applies to all other agencies—other agencies may set user fees only to cover costs *to a specific party*, and not to cover general administrative costs, and costs of providing benefits to the public (see § I.C). The AIA waived that, and allows the PTO to recover all costs of patent operations.

BUT—the constraint of law that the AIA did *not* waive—and could not possibly waive because it's a constitutional constraint on the executive branch—is that the PTO may not "tax." And that means that even with the AIA, the PTO may *not* "adjust assessments to encourage or discourage a particular activity."

The United States Constitution provides in Article I sec. 8 clause 1 provides that the power to "lay and collect Taxes" lies with Congress, not the executive branch. Art. I sec. 7 clause 1 provides that "All Bills for raising Revenue shall originate in the House of Representatives."

The Supreme Court and D.C. Circuit have interpreted the constitutional taxing power in a series of agency user fee cases. The current state of constitutional limits on agency use of fees to incentivize or disincentivizes behavior is summed up in a D.C. Circuit case:

> 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.[5]

A much more detailed explanation of the constitutional limits on fee-setting can be found in an article by Ron Katznelson, which I have attached as an exhibit.[6]

C. The Independent Offices Appropriations Act (IOAA) and Circular A-25

The Independent Offices Appropriations Act of 1952, 31 U.S.C. § 9710, is the basic set of guiding principles for agency user fees. OMB Circular A-25[7] is the OMB guidance for implementation, which the Supreme Court has cited as an authoritative interpretation. The Supreme Court and D.C. Circuit have interpreted the IOAA to impose several constraints:

1. Congress may lay taxes to "encourage" or "discourage," as discussed in § I.B, but not agencies.[8]
2. Most agencies may set fees only for specific services to a specific "identifiable recipient," at the cost of providing that service or the value to the recipient, but may not recover agency general operating costs.[9]
3. Most agencies may set user fees to cover the lesser of agency cost of providing services and things that the agency provides, or "value to the recipient," but the agency may not charge for benefits to the general public or other societal benefits.[10]
4. Where the agency has specific line item data to show both the "value of the service to the recipient" and the "reasonable cost incurred" to provide that service, an agency may charge the lesser of those two amounts.

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[5] *Seafarers International Union v. U.S. Coast Guard*, 81 F.3d 179, 183, 185 n.4 (D.C. Cir. 1996), *quoting National Cable Television Association Inc. v. United States*, 415 U.S. 336 (1974); *cf. National Federation of Independent Businesses v. Sebelius*, 567 U.S. 519, __, 132 S.Ct. 2566, 2594-95 (2012) (because the Affordable Care Act has an exaction designed to incentivize behavior, it is a "tax" and a valid exercise of Congress' taxing authority).

[6] 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), attached as an exhibit, available at https://works.bepress.com/rkatznelson/70.

[7] https://www.whitehouse.gov/wp-content/uploads/2017/11/Circular-025.pdf

[8] *National Cable Television Association Inc. v. United States*, 415 U.S. 336, 340-41 (1974) (*NCTA*); *Seafarers International Union v. U.S. Coast Guard*, 81 F.3d 179, 183, 185 n.4 (D.C. Cir. 1996); *see also Federal Power Commission v. New England Power Co.*, 415 U.S. 345, 351 (1974) ("*NEPCO*") (fees set to reflect "economic climate" are "taxes," and thus impermissible).

[9] *NCTA*, 415 U.S. at 343; *Seafarers*, 81 F.3d at 183.

[10] *NEPCO*, 415 U.S. at 349.

The PTO is special in this respect—AIA § 10(a)(2) gives the PTO a carve-out from one of the provisions of the IOAA, in the form of authority to recover general and administrative costs. However, of the constraints set by the IOAA, AIA § 10 waives only bullet 2. The explicit wording of AIA § 10(a)(1) waives bullet 2 only for those fees "*established, authorized, or charged under title 35*," but the legislative history makes clear that the PTO is to be entirely self-funding, so that would likely be sufficient authorization to build general operating costs into other fees as well.

The prioritized examination statute, § 2(b)(2)(G), and IPR and PGR petitions statutes, § 311(a) and § 321(a), specifically exempt these fees from bullet 2—these fees can be set at something other than cost recovery. "Value to the recipient" may be a good measure under bullet 3.

Fees without statutory grounding are not within § 10, and thus are either barred outright, or are subject to the four constraints of the IOAA.

D. The PTO's final rule notices and the Knight memo have not acknowledged, let alone addressed, the legal constraints

If the PTO was even aware of the constitutional issue or the legislative history during the 2012 fee-setting, there's no mention of it in the 2012-13 record or the 2016-17 record.

General Counsel Knight's memo from February 10, 2012 on USPTO Fee Setting[11] opines that "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." Likewise, the PTO's Final Rule notice from 2013 discusses the issue in its response to Comments 32 and 33.[12]

Mr. Knight's memo and the Final Rule notice explain consistency between the PTO's fee rule and the IOAA (see § I.C). While I agree with the memo's conclusion vis-à-vis the IOAA, the Knight memo is strikingly cagey. It never mentions the IOAA by name or citation, and never mentions of any of the case law interpreting the IOAA. Yet, by using the phrase "encourage or discourage any particular service," a phrase from the key IOAA case law, it seems more than likely that the author of the memo was aware of the IOAA, and yet chose not to mention it by name, and chose not to discuss any interaction between the IOAA and AIA § 10.

The Knight memo and Final Rule notice then take a breathtaking leap: they opine that because the AIA grants the PTO a carve-out from *one* requirement of the IOAA, it breaks the PTO out of *all* requirements of the IOAA, and (apparently) all other laws that govern fee setting. The legal basis for that leap is not explained.

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[11] General Counsel Bernard Knight, Memorandum, USPTO Patent Fee Setting, https://www.uspto.gov/sites/default/files/aia_implementation/fee_setting_opinion.pdf (Feb. 10, 2012).

[12] Patent and Trademark Office, *Setting and Adjusting Patent Fees, Final Rule*, Response to Comments 32 and 33, 78 Fed. Reg. 4211, 4258 (Jan. 18, 2013).

The Knight memo and Final Rule discussion are striking for the things they *don't* say:

- There's no discussion in either document of the AIA legislative history, particularly in the removal of the earlier text, "notwithstanding the fee amounts established or charged," or the discussion in the House report (see page 6). That legislative history is directly on point the conclusion of the memo (see § I.A). It's deeply puzzling to me that a legal memorandum on a brand new statute would have no discussion of legislative history.
- There's no discussion of the effect of the word "only" in the phrase "*only* to recover the aggregate estimated costs." Why would that mean "only" in amount rather than "only" in purpose? If Congress had meant "only" amount, that's the words they would have used. (The legislative history makes clear that Congress intended "only" to apply to purpose as well as amount, see page 6.) It's odd to me that a legal memo intended to accurately advise a client would omit something that's that obvious, and that obviously important.
- In the discussion of the IOAA in the Final Rule notice, there's no mention of the relevant Supreme Court or D.C. Circuit case law. The Knight memo uses the phrase "encourage or discourage any particular" service, a distinctive quote taken from the IOAA case law—so it's clear that the author of the Knight memo was aware of that case law. But there's no discussion of that case law, even though the holdings (especially *Seafarers*) is 180º opposite the outcome of the memo. This is likewise puzzling.
- And there's no mention of the constitutional taxing power. To be fair, that issue wasn't raised in the notice-and-comment letters, at least not in any letter I found.[13] However, it *was* raised in a BNA PTCJ article two months before the Final Rule notice.

I surmise that Mr. Knight was unaware of the constitutional tax issues or the legislative history when he signed this memo, and that the omissions were those of a lawyer lower in the Office of General Counsel However, on the most-relevant issues, there's no indication in the record that the PTO ever even thought about them,[14] and that puts the agency and its fee-setting procedures in a very weak position.

E. What are the fees "established, authorized, or charged under title 35?"

Because AIA § 10(a)(1) only authorizes fee setting for "any fee *established, authorized, or charged under title 35*," and even in that case, only for "for any services performed by or materials furnished by, the Office" it's essential to understand which fees fit in which

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[13] I reviewed the notice and comment letters from 2012. These responses apparently address comments from Ron Katznelson, in his letter of November 5, 2012 https://www.uspto.gov/sites/default/files/aia_implementation/comment-katznelson-2.pdf I see that Dr. Katznelson's *comment letter* relies only on the IOAA, and doesn't mention the constitution. His article (*supra* note 6) is much clearer, that the relevant constraint is the constitution, not the IOAA.

[14] Likewise, in the 2017 Final Rule notice, Patent and Trademark Office, *Setting and Adjusting Patent Fees During Fiscal Year 2017*, Final Rule, 82 Fed. Reg. 52780 (Nov. 14, 2017), there's not a single mention of the word "tax" or "constitution."

pigeonhole. As discussed in § I.A above, Congress made abundantly clear that the authority of Section 10 is constrained by the various fees scheduled throughout titles 35 and 15:

- 35 U.S.C. § 41(a), (b), (d), and (h) "establish" most fees, and set baseline amounts.
- § 41(d)(2)(A), first sentence, authorizes the PTO to create new fee items for "other processing, services, or materials relating to patents *not specified in this section*."
- § 122(e)(1) (third party submissions) authorizes "such fee as the Director may prescribe."
- § 132(b) (RCE's) authorizes "The Director may establish appropriate fees for such continued examination."
- § 156(h) (patent term extension) authorizes that "The Director may establish such fees as the Director determines appropriate to cover the costs to the Office"
- § 257(d)(1) (supplemental examination) directs "The Director shall, by regulation, establish fees for the submission of a request for supplemental examination of a patent,"
- § 261 (recording of assignments) authorizes (but does not require) a fee.
- § 311(a) and § 321(a) require the Director to establish a fee for IPR and PGR petitions.
- § 376(a) and (b) (PCT national stage entry) and § 382 and § 389(c) (Hague convention design applications) are unique: these are the only delegations of authority to the Director to choose what items are fee-bearing *and* what amount.

Other fees are not subject to AIA § 10.

F. Specific examples of unlawful fees

A number of line items in the proposed fee schedule are problematic:

- **Maintenance fees.** The "Detailed Appendix" slides (slide 64) propose that the PTO wants to "restructure issue and maintenance fees," to rebalance the ratio between "back-end" maintenance fees vs. "front-end" processing fees. Congress already made the policy choice: initial filings should be cross-subsidized by maintenance fees, at approximately 50%.[15] Congress (by inference) felt it important to encourage filing, and allow successful patentees to cross-subsidize filing. Constitutionally, it's beyond the PTO's authority to second-guess Congress' policy balance and "tax" to effect the PTO's preference. Under the APA, this is rulemaking relying on "factors which Congress has not intended [the agency] to consider," one of the categories of agency action that's arbitrary and capricious nearly *per se*.[16] The PTO departed from Congress' intent in 2013, and should move back.

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[15] That's not just the statutory language; it's in the legislative history. Pub. L.96-517, 94 Stat 3015 (Dec. 12, 1980); See H. Rep. 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).

[16] *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

- **PDF/DOCX.** The proposed fee for filing a PDF instead of a DOCX is set at $400, and the explanation given is to "encourage" behavior. That's a tax, and thus unconstitutional. The DOCX fee is discussed in more detail in § III.E.

- **Appeal fees.** The proposed fees are entirely out of line with the statutory fees. This is especially concerning, given the high rate of reversal (when reversals at pre-Appeal stage, Appeal Brief stage, and final decision stage are added together, the reversal rate is well over 50%, and last time I assembled all the data, was in the mid-80% range. Appeal is a cost largely created by poor examination quality, not a cost created at the instance of applicants). In drafting § 41, Congress had the PTO's data in hand to understand the PTO's cost structure. Congress set the fees for appeal at a fraction of the actual cost. Congress could easily have had in mind that appeal fees should not penalize applicants for examiners' mistakes. Instead, Congress might well have believed that the PTO should have financial incentives and supervisory oversight to ensure that unfounded rejections are withdrawn before the PTO bears the cost of an appeal. The PTO's fee structure interferes with those (inferable) Congressional concerns.

	§ 41 fee	proposed fee	unit cost FY 2017
Notice of Appeal	540	800	17
Filing a Brief in Support of an Appeal	540	0	n/a
Forwarding an Appeal to the Board	unauthorized	2240	5147
Request for Oral Hearing	1080	1300	1566

And at any rate, for reasons discussed §§ I.A and I.B, the PTO lacks statutory and constitutional authority to second guess Congress' policy balances encoded in the appeal fee line items.

- **RCEs.** Fees for RCEs are authorized to be set by the Director. They are not specifically scheduled in § 41, but they are "authorized." Therefore, § 10 allows the PTO to set those fees, but other laws still apply. The PTO may not set fees to "encourage" or "discourage," (see §§ I.A and I.B), and must honor the provisions of the IOAA that are not waived by § 10(a)(2).

Table lines 62 and 63 show "RCE—1st request" and "RCE—2nd and subsequent." If "RCE 2nd request" is ***lower*** in unit cost, then how can the PTO justify setting the "2nd and subsequent request" fee ***higher***? The PTO's 2013 and 2016 rule notices *have* offered justification for this fee—an illegal justification. The PTO's very own words make clear that the "2nd and subsequent" fee is a tax, and therefore unlawful.

	proposed fee	unit cost FY 2017
Request for Continued Examination (RCE) - 1st Request (see 37 CFR 1.114)	$1,360	$2,235
Request for Continued Examination (RCE) - 2nd and	$2,000	$1,654

Subsequent Request (see 37 CFR 1.114)		

- **Raising the late surcharge for maintenance fees** to "encourage" earlier payment. Congress determined that the public should have clear notice of abandonment on the 4th, 8th, and 12th anniversaries. The PTO disagrees, and thinks the public should know on the 3½, 7½. and 11½ anniversaries. The PTO identifies no statutory delegation of authority for it to hold such an opinion, let alone act on it (I'm only admitted in Massachusetts and New York—I regularly tell clients that I'm not licensed to have an opinion on California or Japan law). Nor does the PTO explain how any rational competitor could reasonably rely on a failure to pay a maintenance fee in the first half of the window to commence investment during the second half—no lawyer would advise a client to undertake the risk of commercial exploitation based on such flimsy information. If this is a good idea, then it's a good idea to secure through a proper law, by Congress.

II. Several fees exceed the authority granted in the AIA, or violate the Independent Offices Authorization Act

A. AIA § 10 sets limits on fee setting authority.

AIA § 10 only permits setting fees "*established, authorized, or charged under title 35*," and within that, only "*for any services performed by or materials furnished*" by the PTO, but nowhere authorizes creating new fees or restructuring existing fees. The legislative history, specifically the removal of the "notwithstanding" clause from § 10, makes clear that the PTO must work with the § 41 fee schedule, and can't willy-nilly create new fees without a specific statutory authorization (see § I.E and the text that was *not* enacted, at page 6). For most fees, the legislative history (see page 7) states that Congress intended the PTO to use the existing § 41 as a "reference point."

There are exceptions, including:

- § 2(b)(2)(G) for prioritized examination
- § 41(d)(2)(A) first sentence, fees for services not otherwise covered in § 41.
- § 376(a) and (b) for PCT national stage entry
- § 382 and § 389(c) for Hague convention design applications

These contrasting exceptions prove the rule—if § 41 covers a fee area, that's the "reference point," and the PTO doesn't have discretion to substitute its judgment.

B. The restructuring of appeal fees exceeds the PTO's authority under AIA § 10

The change from "notice of appeal" and "filing a brief in support of an appeal" of § 41(a)(6) was restructured into "notice of appeal" and "forwarding an appeal to the Board" as in 37 C.F.R. § 41.20(b)(1) and (4). That's unlawful, and needs to be backed out.

C. The IOAA

The IOAA is introduced in § I.C above.

Several fees that are not exempted from the IOAA, and that appear to violate it, are discussed in §§ III.D and III.E, below.

III. Many of the fees require analysis under the public interest protections of Executive Order 12,866, OMB Circular A-4, the Paperwork Reduction Act, and the Regulatory Flexibility Act, and probably cannot survive that analysis

A. Executive Order 12,866 and OMB Circular A-4

Executive Order 12,866 is the basic benefit-cost executive order. In his first weeks in office, President Trump reminded all agencies of E.O. 12,866 and one of its important implementing guidance documents, the *Bulletin on Agency Good Guidance Practices*.[17] These two provide important guidance to the PTO. In relevant part, E.O. 12,866 reads:

> **Section 1.** *Statement of Regulatory Philosophy and Principles.*
>
> (a) *The Regulatory Philosophy*. Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people. In deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating. Costs and benefits shall be understood to include both quantifiable measures (to the fullest extent that these can be usefully estimated) and qualitative measures of costs and benefits that are difficult to quantify, but nevertheless essential to consider. Further, in choosing among alternative regulatory approaches, agencies should select those approaches that maximize net benefits (including potential economic, environmental, public health and safety, and other advantages; distributive impacts; and equity), unless a statute requires another regulatory approach.
>
> (b) *The Principles of Regulation.* To ensure that the agencies' regulatory programs are consistent with the philosophy set forth above, agencies should adhere to the following principles, to the extent permitted by law and where applicable:

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[17] See Office of Management and Budget, *Guidance Implementing Executive Order 13771, Titled 'Reducing Regulation and Controlling Regulatory Costs'.*" M-17-21, § 1 (Apr. 5, 2017) ("[A]gencies must continue to assess and consider both the benefits and costs of regulatory actions, including deregulatory actions, when making regulatory decisions, and issue regulations *only upon* a reasoned determination that benefits justify costs" (emphasis added); Office of Management and Budget, Memorandum, *Interim Guidance Implementing Section 2 of the Executive Order of January 30, 2017, Titled "Reducing Regulation and Controlling Regulatory Costs"*, https://www.whitehouse.gov/sites/whitehouse.gov/files/briefing-room/presidential-actions/related-omb-material/eo_iterim_guidance_reducing_regulations_controlling_regulatory_costs.pdf (Feb. 2, 2017) ("Agencies should continue to adhere to OMB's 2007 Memorandum on Good Guidance Practices.").

> (1) Each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem.
>
> (2) Each agency shall examine whether existing regulations (or other law) have created, or contributed to, the problem that a new regulation is intended to correct and whether those regulations (or other law) should be modified to achieve the intended goal of regulation more effectively.
>
> …
>
> (5) When an agency determines that a regulation is the best available method of achieving the regulatory objective, it shall design its regulations in the most cost-effective manner to achieve the regulatory objective. In doing so, each agency shall consider incentives for innovation, consistency, predictability, the costs of enforcement and compliance (to the government, regulated entities, and the public), flexibility, distributive impacts, and equity.
>
> (6) Each agency shall assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.
>
> …
>
> (8) Each agency shall identify and assess alternative forms of regulation and shall, to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt.
>
> …
>
> (11) Each agency shall tailor its regulations to impose the least burden on society, including individuals, businesses of differing sizes, and other entities (including small communities and governmental entities), consistent with obtaining the regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations.
>
> …

The Office of Management and Budget elaborated on the economic analysis required by E.O. 12,866 for any regulation that may reasonably be expected to "have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities." Guidance and methodological implementation of E.O. 12,866 are provided in OMB Circular A-4.[18] Some of the required components in a Regulatory Impact Analysis include:

[18] https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/circulars/A4/a-4.pdf Those that prefer a smaller typeface can find a version at the Federal Register web site https://www.gpo.gov/fdsys/pkg/FR-2003-10-09/pdf/03-25606.pdf A 16-page "condensed books" primer is at OMB's web site, https://www.reginfo.gov/public/jsp/Utilities/circular-a-4_regulatory-impact-analysis-a-primer.pdf

- Identify a range of regulatory approaches.[19]
- Estimate the benefits and costs—both quantitative and qualitative—of the proposed regulatory action and its alternatives
- Identify the Consequences of Regulatory Alternatives
- Quantify and Monetize the Benefits and Costs
- Evaluate Non-quantified and Non-monetized Benefits and Costs
- Characterize uncertainty in benefits, costs, and net benefits

B. The Paperwork Reduction Act

The Paperwork Reduction Act, 44 U.S.C. § 3506(c)(2) has its own notice-and-comment requirement, which most agencies run in parallel with the APA comment period:

> (c) With respect to the collection of information and the control of paperwork, each agency shall—
>
> (A) … provide 60-day notice in the Federal Register, and otherwise consult with members of the public and affected agencies concerning each proposed collection of information, to solicit comment to—
>
> (i) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility;
>
> (ii) evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;
>
> (iii) enhance the quality, utility, and clarity of the information to be collected; and

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Note that since the total national budget for patent applications and prosecution is about $5 billion per year, this requirement for an economic analysis is triggered by any regulation that covers 2% of all patent prosecution. It's striking that the PTO has never undertaken a Regulatory Impact Analysis for any regulation other than its fee-setting rules.

[19] Why has the PTO not focused on internal reforms to reduce costs, as an alternative to raised fees? *E.g.*, IEEE-USA gave an extensive set of comments on how internal PTO processes and incentives could be restructured to reduce costs to the PTO and to applicants. Comment letter under Paperwork Reduction Act (29 May 2012), at https://www.uspto.gov/sites/default/files/news/fedreg/comments/0651-0031_IEEE_Comment.pdf

Other suggestion letters from well-informed commentators abound. Ron Katznelson, *Patent Reforms Must Focus on the U.S. Patent Office*, Medical Innovations & Business Journal at 77 (Summer 2010), https://www.uspto.gov/sites/default/files/documents/2015quality_f_katznelson2_19may2015.pdf

> (iv) minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and
>
> (B) for any proposed collection of information contained in a proposed rule (to be reviewed by the Director under section 3507(d)), provide notice and comment through the notice of proposed rulemaking for the proposed rule and such notice shall have the same purposes specified under subparagraph (A)(i) through (iv);
>
> (3) certify (and provide a record supporting such certification, including public comments received by the agency) that each collection of information submitted to the Director for review under section 3507—
>
> (A) is necessary for the proper performance of the functions of the agency, including that the information has practical utility;
>
> (B) is not unnecessarily duplicative of information otherwise reasonably accessible to the agency;
>
> (C) reduces to the extent practicable and appropriate the burden on persons who shall provide information to or for the agency, including with respect to small entities, as defined under section 601(6) of title 5, the use of such techniques as—
>
> (i) establishing differing compliance or reporting requirements or timetables that take into account the resources available to those who are to respond;
>
> (ii) the clarification, consolidation, or simplification of compliance and reporting requirements; or
>
> (iii) an exemption from coverage of the collection of information, or any part thereof;
>
> (D) is written using plain, coherent, and unambiguous terminology and is understandable to those who are to respond;
>
> (E) is to be implemented in ways consistent and compatible, to the maximum extent practicable, with the existing reporting and recordkeeping practices of those who are to respond. …

C. Executive Order 12,866 and the absence of benefit-cost analysis

This fee-setting regulation is "likely to result in … annual effect on the economy of $100 million or more," E.O. 12,866 § 3(f)(1), and thus requires a full Regulatory Impact Analysis under Circular A-4. Why has no past RIA ever "identified a range of alternative approaches?"[20] Past analyses have considered non-starter alternatives like not raising fees at all, setting all fees at actual cost, applying only inflation adjustment. Of course, against these nonstarter strawmen, the PTO's preferred alternative looks really good.

But why has there never been an analysis of the alternative required by statute and the Constitution, raising all fees proportionally from the baseline set by Congress, with deviations only where the PTO has specific data to support a deviation? After all, that's the constitutionally required alternative—the current fee schedule, with its incentives here and disincentives there, is

[20] *See* Katznelson, *Scope of Fee-Setting Authority*, note 6, *supra*.

an unconstitutional "tax." Considering only phony strawmen as "alternatives" is not compliant with the PTO's obligations under the letter of the law,[21] and can't be reconciled with the "regulatory philosophy" or spirit of the law. Artificially narrowing the options is arbitrary and capricious *per se*.[22] Indeed, developing and vetting alternatives is one of the essential goals of the notice and comment process.[23]

Similarly, I did a keyword search in the PTO's past Regulatory Impact Analyses for words that, under Circular A-4, ought to be there. They aren't.

The factors that an agency is directed to consider under Circular A-4 are designed to assist agencies in considering a range of regulatory alternatives, and to choose from among them to ensure that the agency best balance all regulatory priorities. The low compliance of the PTO's rulemaking activities ought to be a concern of PPAC.[24] As I noted in the opening to this letter and in section VI below, the laws are there to ensure that the PTO acts in the public interest. They're not "bureaucratic sport" or needless burden to be ignored.

D. The proposal to impose an annual fee and CLE requirement

The proposal proposes to create new fees for "Annual Active Patent Practitioner Fee … without certifying continuing legal education (CLE) completion" and "…with certifying continuing legal education (CLE) completion."

The proposal is completely silent on rationale for creating the annual fee (there's a few sentences of rationale for the CLE discount, but not for the fee). Case law under the Administrative Procedure Act, § 553, and the text of the Paperwork Reduction Act and Executive Order 12,866 require that the agency provide a discussion of rationale, and an estimate of costs.

The proposal materials are entirely silent on several legally-required issues relating to the annual fee proposal:

- The materials identify no statutory authorization. § 41(d)(2)(A) permits the Director to "establish fees for all other processing, services, or materials," which this isn't.

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[21] An "agency must consider reasonably obvious alternatives and, if it rejects those alternatives, it must give reasons for the rejection…" *Yale-New Haven Hosp. v. Leavitt*, 470 F.3d 71, 80 (2d Cir. 2006).

[22] *Pillai v. Civilian Aeronautics Board*, 485 F.2d 1018, 1027 (D.C. Cir. 1973).

[23] *Owner-Operator Independent Drivers Ass'n v. Fed Motor Co.*, 494 F.3d 188, 199–203 (D.C. Cir. 2007) (rule invalid when agency failed to disclose the data and assumptions on which it based its benefit-cost analyses); *Home Box Office Inc. v. Federal Communications Comm'n*, 567 F.2d 9, 36 (D.C. Cir. 1978) ("an agency proposing informal rule-making has an obligation to make its views known to the public in a concrete and focused form so as to make criticism or formulation of alternatives possible").

[24] One expert in the field, Dr. Richard Belzer, a Harvard-trained economist and former regulatory oversight economist from OMB, gave an evaluation of the PTO's compliance with basic regulatory principles, and offered a number of suggestions. I discuss his recommendations in § VI

§ 2(a)(2)(D) authorizes the Director to "govern recognition and conduct of agents [and] attorneys," but there's no fee authorization in § 2(a)(2)(D).

- AIA § 10(a)(1) only authorizes the Director to "adjust by rule any fee *established, authorized, or charged under title 35*." § 10 does not authorize creating new fees, only adjusting existing fees (see § II.A). Because this is not a fee within the AIA § 10, the Independent Offices Appropriations Act applies. The IOAA and its implementing case law limit the PTO's ability to set levels of new user fees—the PTO may charge fees to cover actual cost, but not to create cross-subsidies, or to influence behavior.[25] Thus, at highest, an attorney registration fee can be at cost-recovery.
- There's no statement of any reason for it. E.O. 12,866 § 3(f)(1) requires that the PTO "identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem." The Administrative Procedure Act also requires a statement of rationale at proposal stage. The "Executive Summary" slides (slides 24-27) explain how it would work, but there's no rationale, no statement of purpose, no explanation of either need or benefit for the fee.
- E.O. 12,866 § 3(f)(1) requires that the PTO "assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs." There's no estimate of either costs or benefits, and thus no balancing.
- The Paperwork Reduction Act and Regulatory Flexibility Act require the PTO to account for estimates of the effect on small entities (most patent prosecutors are solos or small firms), an accounting of costs for reporting, recordkeeping, and other compliance costs. The PTO didn't.
- The PTO must be able to *certify* that the requirement is "*necessary* for the proper performance of the functions of the agency." 44 U.S.C. § 3506(c)(3)(A). The PTO has run an attorney registration program for the better part of a century without an annual registration or CLE requirement—why have they suddenly become "*necessary*?"
- The PTO must be able to *certify* that the requirement is implemented in ways "consistent and compatible, to the maximum extent practicable, with the existing reporting and recordkeeping practices of those who are to respond," including for those attorneys in states that do not have existing CLE requirements, and for all agents.
- The PTO proposes that "Encouraging CLE, by offering a discount, will improve the quality of the bar and therefore of the resulting patents." *Detailed Appendix* slide 65. If it's about "encouraging," it's an unconstitutional tax.

[25] *See* §§ I.A (legislative history), I.B (constitutional taxing power), and I.C (IOAA) above, and Katznelson, *Scope of Fee-Setting Authority*, note 6, *supra*.

- This fee would raise about $5 million per year for the PTO. The Paperwork Reduction Act requires that the PTO estimate *all* costs—searching for appropriate CLE courses, travel, attendance, fees for the courses, tracking the paperwork, recordkeeping, submitting it to the PTO, docketing the annual act of paying the fee, firm administration to ensure that all attorneys are up to date, and the like. Multiplying out some estimated numbers, it seems that added costs would lie in the range of $40-$100 million per year. Before proceeding, the PTO will have to show public benefit in the same range, and that the annual fee is the least costly way to achieve the benefit. (The burden of proof is on the agency.) OED gets its current funding out of the general patent fund—no paperwork muss, no fuss. What's wrong with that?

Circular A-4 then requires that the agency "Quantify and monetize the benefits and Costs" and "evaluate non-quantified and non-monetized benefits and costs " The PTO has not done so.

The laws that govern regulatory analysis required the PTO to perform a benefit-cost analysis, and make the analysis public so that the public could meaningfully participate in the PPAC hearing. Maybe an attorney registration fee is a good idea. Maybe not. Maybe it would be counterproductive to the PTO's budget—maybe the costs of administration would nearly eat up the revenue. Regulatory analysis is mandatory precisely to ensure that agencies don't leap before they look, and benefits the agency when the agency can show the public that it's acting for public benefit, not for agency benefit.

Regulatory analysis isn't something that agencies do when they feel like it; it's something that law-abiding agencies do for every regulation that "that is likely to result in a rule that may … have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy,"[26] under the Executive Order 12,866 and Circular A-4. It's something agencies do for any regulation that requires the public to submit paperwork to the agency, under the Paperwork Reduction Act.[27] Because a high fraction of patent practitioners are employed by small entities, analysis under the Regulatory Flexibility Act is also required.

E. The proposal to discount for DOCX below PDF

The materials for the "Non-DOCX Filing Surcharge" state (this is the full extent of the rationale, almost word-for-word the same in the *Executive Summary* slides and the *Detailed Appendix* slides):

- This fee will encourage applicants to use DOCX for filing, which will improve examination quality and lower processing costs.
- Applications filed using DOCX will be more accessible in future searches of publication materials.

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[26] Executive Order 12,866 § 2(f)(1).

[27] 44 U.S.C. § 3506.

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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.

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[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

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[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]

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[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]

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[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

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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

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[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.

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[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

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[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

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[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).

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).

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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

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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 filings is the ratio between the total fee collection for each fee category and the fee set for that category. Incidence is small-entity RCE filings 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.

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To be continued

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