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PRIOR USER RIGHTS: STRENGTHENING U.S. MANUFACTURING AND INNOVATION

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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PRIOR USER RIGHTS: STRENGTHENING U.S. MANUFACTURING AND INNOVATION

WEDNESDAY, FEBRUARY 1, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION, AND THE INTERNET,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:08 a.m., in room 2141, Rayburn Office Building, the Honorable Bob Goodlatte (Chairman of the Subcommittee) presiding.

Present: Representatives Goodlatte, Quayle, Sensenbrenner, Coble, Chabot, Issa, Jordan, Adams, Watt, Conyers, Chu, Sánchez, Lofgren, Waters, and Johnson.

Staff present: (Majority) Vishal Amin, Counsel; Olivia Lee, Clerk; and (Minority) Stephanie Moore, Subcommittee Chief Counsel.

Mr. GOODLATTE. Good morning. This hearing of the Subcommittee on Intellectual Property, Competition, and the Internet, and on the subject of Prior User Rights: Strengthening U.S. Manufacturing and Innovation will come to order, and I have an opening statement.

Today we are holding a hearing on the prior user defense. This provision was included as an integral part of the Leahy-Smith America Invents Act, and the move to a first inventor to file system.

The AIA was the first patent reform bill in over 60 years, and the most substantial reform of U.S. patent law since the 1836 Patent Act. This legislation brought together individuals and businesses that represent the full spectrum of the American economy—from individual inventors to businesses and job creators of all sizes from the technology, pharmaceutical, manufacturing, biotech, consumer goods, finance, defense and retail sectors.

The prior user rights provision was developed to ensure that it created a strong right for those who first commercially use inventions, protecting the rights of early inventors, and giving manufacturers a powerful incentive to build new factories in the United States to keep and bring jobs back home. The provision helps to ensure that factories are able to continue using manufacturing processes without the fear of costly litigation. This ensures that the first inventor of a new process or product used in manufacturing can continue to do so.

The AIA's prior user defense protects American manufacturers from having to patent the hundreds of thousands of processes they

use in their facilities. Further, prior user rights are an important part of the switch to a first inventor to file system. For many manufacturers, the patent system presents a Catch-22. If they patent a process, they disclose it to the world, foreign manufacturers will learn of it, and in many cases use it in secret without paying licensing fees. The patents issued on manufacturing processes are very difficult to police and oftentimes patenting the idea simply means giving the invention away to foreign competitors. On the other hand, if the U.S. manufacturer does not patent the process, then under the pre-AIA patent system, a later party can get a patent and force the manufacturer to stop using a process that they independently invented and used. Due to this litigation threat, it has been easier for a factory owner to idle or shut down parts of a plant and move operations and jobs overseas rather than risk their livelihood through an interference proceeding before the USPTO.

It is important to note that under the AIA, interference proceedings have been eliminated for patents that will be issued under the first inventor to file system. A less costly derivation proceeding will be used to settle such disputes within the USPTO.

Post-AIA, the factory owner who has been commercially utilizing an innovation can continue doing so even if a subsequent patent is issued. The AIA's prior user rights provision results in an equitable outcome whereby a factory stays open, jobs stay here, and the subsequent patent owner gets to keep their patent albeit within a limited carve-out to the prior user.

Currently, nearly every foreign country that has adopted a first inventor to file system recognizes prior user rights. We are here today to look at the recently issued AIA report on prior user rights, and also to examine whether we need to improve the prior user defense going forward.

In particular, two key areas have stood out for further discussion.

This includes reducing the 1-year trigger for the prior user defense that requires that action be taken 1 year prior to the earlier of either the effective filing date of the claimed invention or the date of public disclosure to qualify.

And second, modifying the prior user defense to account for the situation where a company has taken substantial steps toward commercialization.

As part of the AIA, an interagency report on prior user rights was mandated. When we were first drafting the bill, we slotted the report to take 1 year to finish, but after talking with Director Kappos, he was confident that it could be done in a quarter of the time.

So we wrote in a 4-month deadline for the report starting the day H.R. 1249 was signed into law. I am pleased to see that the report has arrived on time and under budget.

Well, at least I can confirm that the report arrived on time, though I am sure that Director Kappos will be able to confirm that it came in under budget. I look forward to hearing from all of our witnesses on the findings of the report, and also engage in a discussion on how we can improve the prior user rights defense going forward to promote U.S. manufacturing technology and innovation.

It is now my pleasure to recognize the Ranking Member of the Subcommittee, the gentlemen from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. If I can get my microphone to cooperate I will make an opening statement also.

I thank the Chairman for convening this hearing. American intellectual property whether in the form of patents, copyrights, trademarks or trade secrets should be shielded from theft, piracy and infringement. Constructing an effective shield is vital to the U.S. economy and consumers, and is the challenge of policymakers and the law.

For that reason, I supported the inclusion of a robust prior user rights defense in the America Invents Act with a carefully crafted consensus carve-out for universities. Prior user rights appropriately recognize and reward commercial ingenuity by allowing manufacturers to continue using innovations that benefit the public, that were created before a patent application was filed by another party.

It is not always feasible or desirable for every true invention to receive patent protection. Such a requirement could stymie progress and delay marketing and manufacturing of products that improve the quality of life for our citizens.

Moreover, because the patent system is premised upon disclosure—a policy that incentivizes businesses to reveal all new technologies in order to avoid legal liability would have the perverse effect of allowing foreign markets to capitalize on American intellectual investments.

By affording cover for a restricted category of undisclosed innovations, however, the prior user rights provision represents a fair balance between trade secrets and patented inventions within the marketplace. It protects all businesses, big and small, and levels the playing field for U.S. industries against foreign competitors who enjoy prior user rights in their home country.

The conversion to a first to file system also mandated by the America Invents Act could not effectively promote and reward American innovation without the fundamental prior user rights defense. Absent an effective prior user rights defense the race to the Patent Office under the first to file system would likely have led to lower quality defensive patent applications covering trade secrets from multiple industries.

Moreover, a robust prior user rights defense was essential to harmonize U.S. adoption of the first to file system with similar systems throughout the rest of the world. The U.S. Patent and Trademark Office report on the prior user right defense concludes that the provisions in the America Invents Act, "need not be altered at this time", and "should be maintained with no change".

However, some have raised concerns both about the amount of progress toward commercialization and about the 1-year durational requirement necessary to trigger the defense. They maintain that the current standard is not on par with what is practiced in other countries, and consequently puts our private sector industries at a disadvantage from foreign competition.

I am anxious to hear the views of our witnesses about these concerns. There is clearly unfinished business for our Nation to secure the intellectual property rights of our inventors and creative com-

munities from threats of infringement and deceptive practices, especially from abroad.

But I am also mindful of the painstaking process that led to the compromises embodied in the America Invents Act.

I look forward to hearing from the witnesses about whether additional legislative action is necessary or desirable to reinforce the global competitiveness of American companies and whether that action can be undertaken without betraying the good faith concessions made by our Nation's university associations on the prior user rights defense.

It seems to me that the conclusion of the U.S. Patent and Trademark Office that Congress should make no changes at this time sets a high bar to demonstrate otherwise.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Mr. GOODLATTE. I thank the gentleman.

The Chair is pleased to recognize the Ranking Member of the full Committee, the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thanks, Chairman Goodlatte and Mr. Watt.

I don't want to take the time to all of us say the same thing three times, so I will put my statement in the record with this recommendation.

I think that we might want to find a way to resolve these differences before 2015. And so all I am doing is suggesting that in a year from now, we look at what has actually been happening. The President signed the bill a few months ago so I think about a year from now we will be able to look at this more critically. I think we are moving in the right direction. I supported the major bill signed September 16, and I think that our leader here of the intellectual property trademark office—and by the way, I am glad that there is one coming to Detroit, which we are looking forward to help develop and I hope that it will be useful. But I commend the Under Secretary Kappos, and also join in welcoming him to the hearing and I will put the rest of my statement in the record.

[The prepared statement of Mr. Conyers follows:]

Prepared Statement of the Honorable John Conyers, Jr., a Representative in Congress from the State of Michigan, Ranking Member, Committee on the Judiciary, and Member, Subcommittee on Intellectual Property, Competition, and the Internet

Today's hearing focuses on the prior user rights defense provision included in the Leahy-Smith America Invents Act (AIA), which President Obama signed on September 16, 2011.

I recognize the sensitivities that surrounded the prior user rights debate and do not believe we should wait until 2015 to reevaluate the economic impacts of the prior user rights defense as the United States Patent and Trademark Office report recommends. That is too long to wait.

We want to be fair and contemplate all of the concerns that are raised by technology companies as well as consider concerns raised by the higher education community with respect to prior user rights.

Nonetheless, I recognize that the bill was enacted last September, so I recommend that a year from now we come back and look at this issue to see what has developed. At that point, we should have additional evidence about whether this issue warrants more hearings or more reports.

There are several critical issues that we should consider during this hearing. First, there is the fundamental inquiry as to whether this provision can be modified to boost innovation and aid the manufacturing sector.

The prior user rights defense permits someone who had been making or using an invention to continue to do so after the invention has been patented by another.

Before enactment of the AIA, the prior user defense was applicable only to business method patents, which made it a limited defense. This defense was created in response to the 1998 Federal Circuit decision in *State Street Bank & Trust Co. v. Signature Financial Group.*

In the *State Street* decision, the Federal Circuit explicitly held that business method patents were patentable.

The AIA enlarged the prior user rights defense to patent infringement to safeguard third parties who can establish that they were commercially using an invention at least one year before the filing date of a patent application in regard to such invention. The AIA extends the prior user rights defense to all patents, not simply business method patents.

The prior user rights provision in the AIA was drafted to establish a powerful defense for those who first commercially use inventions, and to provide manufacturers an incentive to build new factories in the United States.

A prior user right defense has been used by many countries and is used as a counterpart in many first-to-file systems.

Another concern is whether the prior user rights provision adequately protects universities. As many of you will recall, university associations and their memberships raised serious concerns about this provision during the debate on AIA.

Over the six years that we debated patent reform, the higher education community voiced substantial concerns about the increase of prior user rights to be used as a defense against infringement for all patents.

At the same time, numerous organizations in the private sector argued that there was a need for broad prior use defense, especially if the U.S. moved from a first-to-invent to a first-to-file system for determining patent priority.

AIA included a prior user rights provision to address the concerns of the higher education community.

The Act's defense provision has been drafted to maintain a high burden of proof and shield universities and technology transfer organizations from its enforcement.

Supporters of the prior user language in the Act argue that university concerns have been addressed because all university patents are exempt from the assertion of a prior use defense, except those that result from research that could not have been conducted with federal funds.

In apparent response to all of these concerns, section 3 of the AIA required the United States Patent and Trademark Office to study and report to Congress on prior user rights.

In light of the fact that this report was just issued last month, today's hearing provides a timely opportunity to consider the results and recommendations of this report.

The report was developed in consultation with the office of the United States Trade Representative, the Justice Department, and the State Department.

It reflects critical input that the USPTO received from a public hearing that it conducted and from interested parties who shared their opinions about this provision.

The study compares the operation of prior user rights in other industrialized countries with the law in the United States. Specifically, the report examines the effects of prior user rights on innovation, startups, and venture capital. The report also looks at the legal issues that arise with trade secret law and the impact of switching to a first-to-file patent system.

According to the USPTO report, the "prior user right defense under the AIA should be maintained with no change at the present time because there is no substantial evidence that it will have a negative impact on innovation, venture funding, small businesses, universities, or independent inventors."

Additionally, the report suggests that the "USPTO should reevaluate the economic impacts of prior user rights as part of its 2015 report to Congress on the implementation of the AIA, when better evidence as to these impacts might be available."

The report concludes that the AIA strikes the right balance by limiting the prior user rights defense to those parties that can prove commercial use at least one year prior to the filing date of the patent application by clear and convincing evidence.

We heard many arguments against expanding prior user rights that included the need for public disclosure in the patent system. There was also an argument that the patentee receive a limited monopoly in return for disclosing new knowledge to the public.

Supporters of broader prior user rights argue that in complex products and manufacturing processes, which contain hundreds or thousands of patented components, it may not make sense to patent every component or process.

Supporters also argued that prior user rights are essential to ensure that those who have invented and used a technology but choose not to disclose that technology are provided a defense against someone who later patents the technology.

I expect to hear that some of the changes that can be made to the prior user language can include changing the requirement of commercial use one year before filing of the patent application or publication of the invention.

In addition, there are those who argue that "commercial use" should be modified to explicitly include substantial preparation for the actual internal commercial use or arms length commercial transfer of a useful end result.

While we consider if the language of prior user rights should be improved, I would like to note one thing about the AIA that I am particularly pleased was included. The AIA requires the USPTO to establish 3 satellite offices within 3 years of the Act's enactment, which is September, 2014.

I am particularly pleased that the very first PTO satellite office will be in Detroit this summer as the Elijah J. McCoy United States Patent and Trademark Office, located on 300 River Drive.

The USPTO estimates that this satellite office will create more than 100 high technology jobs.

This is a positive development and I look forward to working with the USPTO and the Commerce Department to make sure the office opening is successful.

We all invested a significant amount of effort over the years in working on patent reform legislation.

Our patent system has been immensely successful at promoting the advancement of the useful arts and sciences. Our Nation's economic future is dependent on our ability to innovate and efficiently and effectively protect the products of that innovation.

I look forward to hearing from our witnesses whether there are particular ways that the prior user rights defense language can be improved.

Mr. GOODLATTE. I thank the gentleman.

Without objection, all their opening statements will be made a part of the record.

And we have two very distinguished panels of witnesses today. Each of the witnesses' written statements will be entered into the record in its entirety, and I ask each witness to summarize their testimony in 5 minutes or less.

To help you stay in that time, there is a timing light on your table. When the light switches from green to yellow, you have 1 minute to conclude your testimony. When the light turns red, it signals that the witness' 5 minutes have expired.

Before I introduce our witnesses, I would like them to stand and be sworn. We will do this one panel at a time. We don't need to wait for the next panel, to swear them.

[Witness sworn.]

Mr. GOODLATTE. Thank you very much and welcome.

Our first witness is the Honorable David Kappos, Under Secretary and Director of the U.S. Patent and Trademark Office. Director Kappos served in this role since August 2009, advising the President, the Secretary of Commerce and the administration on intellectual property matters.

Before joining the U.S. Patent and Trademark Office, Director Kappos served as Vice President and Assistant General Counsel for Intellectual Property at IBM, where he managed worldwide intellectual property operations.

Director Kappos received his Bachelor of Science degree in electrical and computer engineering from the University of California, Davis, and his law degree from the University of California, Berkeley. Welcome.

TESTIMONY OF DAVID J. KAPPOS, UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY, AND DIRECTOR, U.S. PATENT AND TRADEMARK OFFICE (USPTO)

Mr. KAPPOS. Well, good morning, Chairman Goodlatte, Ranking Member Watt and Members of the Subcommittee. Thank you for this opportunity to discuss the issue of prior user rights, and the prior user rights defense and the report the USPTO prepared pursuant to the Leahy-Smith America Invents Act.

As you are well aware, the AIA represents the most significant and necessary modernization of our Patent laws in many decades. Mr. Chairman, you and the Members of the Judiciary Committee deserve special praise and our special thanks for your tireless and successful efforts over multiple Congresses toward enactment of the AIA.

We at the USPTO are in your debt, and we have already taken a number of steps necessary to implement the new law including issuing proposed rules and completing two of the seven studies required by the AIA to evaluate specific provisions of the legislation.

Among the many important components of the AIA is the expansion of the prior user rights defense to infringement to apply to all classes of patents. The prior user defense protects third parties who can demonstrate that they commercially used an invention for at least a year prior to the filing date of the patent application relative to that invention.

As I have said in previous testimony before this Subcommittee, I believe that expanding the prior user defense is pro-manufacturer, pro-small business and, on balance, good policy.

Section 3(m) of the AIA directed the USPTO to prepare a report on specific issues regarding the defense including the operation of the prior user rights in industrialized countries, impact on innovation in small business, impact on trade secret law, and the relationship with the first inventor to file patent system. In preparing the report, we conducted our own research, we held a public hearing, and solicited comments from stakeholders. We also obtained input from USTR, the Department of Justice, and the Department of State.

Most of the comments we received supported the AIA's prior user rights defense provision, though several did express concerns.

While a few comments took a view that prior user rights may have the consequence of promoting secrecy over disclosure, the vast majority of comments noted that the ability to maintain trade secrets is vital to American competitiveness and job growth, and that a limited prior user rights defense is an appropriate complement to a first to file system.

In summary, Mr. Chairman, we found that the AIA strikes the right balance by limiting the prior user rights defense to those parties who can prove by clear and convincing evidence commercial use at least 1 year prior to the filing date of the patent application. We believe that patent owners' rights will not be unjustly impaired and that the defense will not have a negative impact on small business or independent inventors.

Further, we believe that the defense is constitutional and can legally coexist with trade secret law.

Lastly, the defense is a proper fit with a first inventor to file system and represents a significant step toward patent law harmonization with our trading partners.

Based on our findings, Mr. Chairman, we made a number of recommendations including the need of the USPTO to reevaluate the economic impacts of prior user rights as part of our report on AIA implementation in 2015, although we would be happy to do it even sooner if that is requested by the Committee.

While our recent report recommends that no legislative alteration of the provisions is necessary at this time, we believe that stakeholder concerns should be carefully and continuously reviewed and possibly addressed in future legislation. Such changes could indeed strengthen the defense for U.S. manufacturers while still protecting the vital interests of our university community.

Mr. Chairman, again thank you for this opportunity to share our views on this important issue. And thank you for your continued strong support of the employees and operations of the USPTO.

[The prepared statement of Mr. Kappos follows:]

STATEMENT OF

DAVID J. KAPPOS

UNDER SECRETARY OF COMMERCE FOR INTELLECTUAL PROPERTY
AND
DIRECTOR OF THE UNITED STATES PATENT AND TRADEMARK OFFICE

BEFORE THE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY,
COMPETITION AND THE INTERNET
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

"Prior User Rights"

FEBRUARY 1, 2012

Introduction

Chairman Goodlatte, Ranking Member Watt, and Members of the Subcommittee:

Thank you for this opportunity to discuss the issue of the "prior user rights" defense and the report prepared by the United States Patent and Trademark Office (USPTO) pursuant to section 3(m) of the Leahy-Smith America Invents Act (AIA).

The AIA represents the most significant – and necessary – modernization of our patent laws in many decades. Mr. Chairman, you and the members of the Judiciary Committee deserve special praise for your tireless and successful efforts over multiple Congresses toward enactment of the AIA. We have already taken a number of steps necessary to implement the new law including issuing proposed rules and completing two of the seven studies required to evaluate the provisions in the new law.

Among the many important components of the AIA are the expansion of the "prior user rights" defense to infringement and the broadening of the classes of patents that are eligible for the new defense. The prior user defense protects third parties who can demonstrate that they were commercially using an invention for at least one year prior to the filing date of a patent application by another relative to that invention. As I've said in previous testimony in front of this committee, I believe that expanding the prior user defense is pro-manufacturer, pro-small business, and, on balance, good policy, so I was happy to see that a compromise was reached and that a prior user right defense was included in the final version of the AIA.

U.S. law already provided, prior to the AIA, a prior user rights defense to patent infringement that was limited to patents directed to methods of doing or conducting business. The AIA extends the prior user rights defense to patents covering all technologies, not just business methods. At the same time, the AIA includes several limitations and exceptions to the prior user rights defense, including a prohibition against license, assignment or transfer of the defense, other than in connection with an assignment or transfer of the entire business to which the defense relates. The defense is geographically limited to cover only those sites where the invention was used before the critical date. And, finally, there is an explicit exception to

the defense for patents owned by or assigned to universities or affiliated technology transfer organizations. These limitations and exceptions address the equitable interests of patentees, universities and affiliated organizations.

In response to concerns expressed during the legislative debate about the impact of an expanded prior user rights defense on the patent system and innovation in general, section 3(m) of the AIA directed the USPTO to study and prepare a report on specific, relevant issues including: the operation of prior user rights in the industrialized world; impact on innovation and small business; impact on trade secret law; and the relationship with a first-inventor-to-file patent system.

Outreach to Stakeholders

Pursuant to the Congressional directive, the USPTO held a public hearing and solicited written comments from interested parties to complement its own independent research on the issue of prior user rights. USPTO is following a similar model of outreach to stakeholders for each of the studies required under the AIA. Additionally, the USPTO consulted with, and obtained input from, the Office of the United States Trade Representative (USTR), the Department of Justice (DOJ), and the Department of State (DOS).

The USPTO heard testimony from six witnesses at the hearing and received 19 written comments from a broad spectrum of foreign and domestic stakeholders, including industry organizations, universities, bar associations, and individuals. Most of the comments supported the AIA's prior user rights defense, though several expressed concerns about the effect such a defense could have on patent valuation and the prompt disclosure of new innovations. In this respect, a number of comments discussed the interaction between patents and trade secrets as a business strategy for protecting inventions. While a few comments took a view that prior user rights may have the consequence of promoting secrecy over disclosure to the detriment of the patent system, by far most comments noted that the ability to maintain trade secrets is vital to American competitiveness and job growth, and that a limited prior user right defense is an appropriate complement to a first-to-file system.

Findings

Based on analysis and review of the stakeholder comments, USPTO's own research, and input provided by USTR, DOJ, and DOS, the USPTO made the following findings:

1. The AIA strikes the right balance by limiting the prior user rights defense to those parties that can prove commercial use at least one year prior to the filing date of the patent application by clear and convincing evidence.

2. The scope of the prior user rights defense includes limitations on the type of continued activities, the transfer of personal rights, and the enforcement of said rights, such that the patentee's rights are not unjustly impinged and the university community may benefit, since the defense is not available in patent actions by universities.

3. There is no substantial evidence that prior user rights as established in the AIA will have a negative impact on innovation.

4. There is no substantial evidence showing that prior user rights as established in the AIA will have a disproportionately negative impact on venture-capital investments to small businesses and startups.

5. There is an insufficient basis to recommend a change to the scheme chosen by Congress with respect to the application of prior user rights to universities.

6. There is no substantial evidence that the limited prior user rights defense as established by the AIA will have a negative impact on small businesses or independent inventors.

7. A prior use defense to patent infringement is both Constitutional and lawful and the defense is consistent with the Constitution and Supreme Court precedent recognizing that trade secret law and patent law can, and do, legally co-exist in the United States, and indeed have co-existed since our Constitution was created.

8. Trade secret protection is of considerable value to United States businesses and the United States economy, and as such, there are compelling economic and policy justifications for providing a prior user rights defense to patent infringement.

9. Providing limited prior user rights in a first-inventor-to-file system addresses the inherent inequity such a system creates between an earlier commercial user of the subject matter and a later patentee. A prior user rights defense is pro-manufacturing and pro-jobs, as it rewards businesses that put new technology promptly into commercial use, and provides protection for early commercial use when challenged by the later filing of patent applications by other entities.

10. Because the availability of a prior user rights defense to patent infringement is a fundamental aspect of many patent regimes throughout the industrialized world, there is a strong preference that United States businesses be afforded the same advantages in terms of prior use protections in the United States that their competitors enjoy abroad.

Recommendations

Consistent with its findings, the USPTO made the following recommendations:

1. The prior user rights defense provisions set forth in the AIA are generally consistent with those of major trading partners and need not be altered at this time.

2. The prior user rights defense under the AIA should be maintained with no change at the present time because there is no substantial evidence that it will have a negative impact on innovation, venture funding, small businesses, universities, or independent inventors.

3. The USPTO should reevaluate the economic impacts of prior user rights as part of its 2015 report to Congress on the implementation of the AIA, when better evidence as to these impacts might be available.

4. United States patent law should provide for a prior user rights defense as an appropriate balance between trade secret protection and patent protection, which legally co-exist to provide competitive advantages for United States businesses.

5. United States patent law should provide for a prior user rights defense to patent infringement in order to address a systemic inequity inherent in a first-inventor-to-file system and to ensure United States businesses are (1) able to protect their investments in the event of a later issued patent and (2) placed on similar footing as competitors in other jurisdictions.

Conclusion

The availability of a prior commercial use as a defense for alleged patent infringement is a fundamental aspect of many patent regimes throughout the industrialized world and the characteristics of the prior use defense in these countries are fairly consistent from country to country. The policy reasons for adopting a prior use defense are also fairly universal - prior user rights remedy the unfairness in holding an "earlier" commercial user liable for patent infringement.

The recently enacted AIA incorporates a carefully crafted prior use defense consistent with the prior use defense found in many industrialized countries of the world. While the USPTO report generally supports the balance struck by the AIA in the commercial use requirement, we note that the one year limitation is significantly more restrictive than the approach used in any other country. It may be that this one year limitation unnecessarily prevents use of the defense by U.S. manufacturers and that some future statutory change might be desirable. Such a change could improve the law by replacing the one-year limitation with a "substantial preparation" requirement which would be more harmonized with the approach taken successfully by other countries and more in keeping with modern commercial reality.

In addition, while not raised in the public comments summarized in the report, some USPTO stakeholders have also questioned the intended scope of the subject matter covered by the provision in the Act. It appears that the intent of this language, similar to other regimes around the world, was to capture all subject matter that otherwise meets the criteria. However, the language here could be clearer if there is a future opportunity to make a technical clarification.

The prior user rights defense as set forth in the AIA is narrowly tailored and not expected to be asserted frequently in patent litigation. There is no substantial evidence that prior user rights will negatively impact innovation, start-up enterprises, venture capital, small businesses, universities or individual inventors. The USPTO will, however, reevaluate the economic impacts of prior user rights as part of its 2015 report to Congress on the implementation of the AIA when better evidence as to these impacts might be available.

A prior use defense to patent infringement, and specifically the one set forth in the AIA, is neither unconstitutional nor unlawful, as the defense is consistent with the Constitution and Supreme Court precedent recognizing that trade secret law and patent law can and do legally co-exist in the United States as they have for hundreds of years. Trade secret protection is of considerable value to United States businesses and the United States economy, and as such, there are compelling economic and policy justifications for providing a prior user rights defense to patent infringement. Providing a suitably limited prior user rights defense in a first-inventor-to-file system is an appropriate response to an inherent inequity such a system creates as between an earlier commercial user of the subject matter and a later patentee. Additionally, there is a strong preference that United States businesses be afforded the same advantages in terms of prior use protections in the United States that their competitors enjoy abroad.

Mr. Chairman, again, thank you for this opportunity to share our views on this important issue, and thank you for your continued strong support for the employees and operations of the USPTO.

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Mr. GOODLATTE. Thank you, Director, and I will start the questioning.

Say a U.S. company is taking substantial steps toward commercializing a product and shares an unpatented trade secret with a subcontractor in a foreign country who is involved in that process. For example, that subcontractor might be in China.

Now what if the subcontractor then shares that information with a third company who then files for patent protection in China, establishing a priority date, and later files in the United States. What type of protection would the U.S. company have apart from a derivation proceeding at the PTO?

Mr. KAPPOS. Well, that is a good question—a bit of a law school hypothetical there. If I follow everything, the derivation proceedings would be the first line of defense. It could be a challenging situation for the U.S. manufacturer.

Another line of defense could be, of course, prior user rights as the obvious tool, and this hypothetical is an example of why prior user rights can be very effective to protect U.S. manufacturing.

The other possible defense I can think of is the claim that the Chinese party wasn't an inventor because they copied the invention from the U.S. provider, but that defense would probably be raised in a derivation proceeding.

Mr. GOODLATTE. In fast moving sectors like the technology and pharmaceutical industries, would it make sense for the prior user rights defense to take into account the issue of substantial commercial preparation?

Mr. KAPPOS. Well, that is a great question. It has been raised already, I think, in some of the floor statements.

Other countries do uniformly take substantial preparations into account. In fact, one of the things we pointed out in our report was that the U.S. approach in AIA is unique in not taking substantial preparations into account. That being said, as I think Ranking Member Watt commented, there was a very delicate balance that was struck, and we need to be cognizant of the needs of the university community in this regard, and make sure we are protecting that important channel for breakthrough inventions to enter the manufacturing marketplace.

And it was that sense of balance that caused us to say, look, we certainly recognize that substantial preparation is a good rubric to use, and would be beneficial to many U.S. industries, probably including pharmaceutical and others.

But a balance was struck, and it was indeed a delicate one.

Mr. GOODLATTE. So you are not prepared to tell us to take that next step yet? Is that what your answer is?

Mr. KAPPOS. Yes. I wouldn't be confident saying that it is clearly necessary at this point.

Mr. GOODLATTE. In your testimony you mention that the 1-year threshold for using the prior user defense in the AIA is significantly more restrictive than the approach used in any other country. Do you think that the threshold should be reduced or eliminated altogether?

Mr. KAPPOS. Well, that question goes hand in hand with the substantial preparation question. The approach that is used in every other country is no 1-year trigger, but a substantial preparation test.

If a change were to be made, probably those two changes would go together. It certainly would be harmonizing, but then again it could have a deleterious effect on the university community, and we are cognizant of the issues there.

Mr. GOODLATTE. Now, to the point that was raised by the Ranking Member of the full Committee, Mr. Conyers, and you mentioned it in your testimony as well, regarding the 2015 report. The USPTO's report on prior user rights concluded that the prior user defense under the AIA should be maintained with no changes and the USPTO should reevaluate the economic impacts of prior user rights when it submits another AIA required report due in 2015 on implementation of the AIA.

Would the 2015 report reflect on more and better evidence than we have currently about the impact of the prior user rights included in the just passed AIA?

I think this is sort of a balancing argument that the sooner you do it, the happier some people might be, but the longer you wait, maybe you will be basing it on better information. What is your comment on that?

Mr. KAPPOS. Well, that is exactly right, Mr. Chairman. We could do a report in another year. The challenge will be that it is going to take some time to build up data. We really need to get data on the impact that the new U.S. system has on the U.S. intellectual property marketplace and on our manufacturing sector.

And it will really only be a few years into the legislation that we will be able to say with some confidence that we have that data.

Now, we can certainly go out and start collecting data more quickly, come in with an interim report if that is helpful, and still do reporting in 2015 as another option.

Mr. GOODLATTE. Thank you.

The Chair recognizes the gentleman from North Carolina, Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman.

Mr. Kappos, I think the Chair has asked in at least one of the questions, and that is on the timing of this. Whether this report may have been required too early in the process before there was really any evidence built up to base a reliable conclusion on.

And, I suppose the real answer, you will continue to study this until 2015—that is what I—and give another report at that time?

Mr. KAPPOS. Yes.

Mr. WATT. Okay.

The second question that one of the witnesses on the next panel has raised is whether the U.S. Patent and Trademark Office is really the appropriate body to be answering this question.

He says that the problem is that under U.S. law the U.S. Patent and Trademark Office has no role in patent infringement analysis, patent litigation or regulation of start-up ventures. The agency has no expertise in this area and yet is being asked to determine the general impact of the law.

A superior body may be the Federal Trade Commission, the courts and the community of U.S. innovators. How do you respond to that?

Mr. KAPPOS. Well, I would respectfully disagree with that point of view. I think, first of all, the United States Patent and Trademark Office is the Administration's advisor on intellectual property issues, intellectual property policy issues.

We of course did, as I mentioned, consult with USTR, the Department of Justice, the Department of State. We conducted a

hearing. We took public comments. We got several dozen public comments.

So the USPTO is acting in large measure as a channel, as a collector and aggregator, and an "analyzer", if you will, of exactly the kind of evidence that the comment calls for.

We also do have expertise in the area that enables us to prepare the kind of report we did, including reaching out overseas, accumulating information going back many years from what other jurisdictions are doing, and putting together views of the entire Administration.

Mr. WATT. So, how consistent are we with the rest of the world? It seems to me that, the more I thought about this after we passed the law and reflecting on the sharing, is that we could be more aggressive in—than we were in the statute on prior user rights to take into account a shorter period, possibly a whole series of things that one of the witnesses has raised on the second panel.

What would it take to get us consistent with the rest of the world?

Mr. KAPPOS. Well, okay. A couple of points. One, we are generally consistent with the new approach that is in the AIA. So, at a high level, we are much more harmonized than we were before.

The places where we are now not harmonized include the 1-year provision that has been mentioned already. The defense has the 1-year look back. The fact that we are not using a substantial preparation kind of a test, and the language in the provision that at one point seems to relate to processes, but then goes back and articulates articles of manufacture and products, compositions as well, which in my view is somewhat confusing language and could frankly on a technical level stand to be cleaned up.

Mr. WATT. All right. I think that addresses the concerns or questions I have. I am not sure that necessarily answers all of them, but this is—we don't have hearings to get answers to all the questions, just to get different perspectives on them.

And I will be anxious to hear the witnesses on the second panel give their perspectives on some of the same issues. So, thank you.

And I yield back, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman.

The gentleman from Arizona, Mr. Quayle, is recognized for 5 minutes.

Mr. QUAYLE. Thank you, Mr. Chairman.

Director Kappos, how has switching from the first to invent system to the first inventor to file system with the inclusion of prior user rights helped to decrease the backlog at the PTO?

Mr. KAPPOS. Well, the switch from first to invent to first inventor to file I believe will be quite helpful relative to the backlog—not really an issue that intersects with prior user rights which come about after patents are issued, generally years down the line.

But just to briefly respond to the core of the question. The switch to the first inventor to file system enables our examiners to have a much more objective view of prior art. In other words, pick up a document and know by looking at the face of the document whether it can be used in examination under the new system.

As opposed to the current system where they really don't know if many documents can be used in examining a patent application,

which hampers them and causes us to be less efficient than we otherwise could be. Having to impose rejections that then later are not sustainable in view of the fact that the date on a prior art document frequently does not determine whether it can be used as prior art currently.

And that is what gets fixed. Under first inventor to file will enable us to move through the examination process more effectively.

Mr. QUAYLE. Okay. And we have all heard about the issue of over-patenting, and the ongoing tension between the volume of patents that are being granted and their quality. Though the AIA was designed to help go a long way toward improving this situation, how do you envision the prior rights defense being used in litigation to defend against weak or overly broad "paper patents"—you know, those types of patents that were basically invented in a law firm rather than in a lab?

Mr. KAPPOS. Well, I think the prior user rights will be very helpful relative to that kind of scenario without commenting on over-patenting or under-patenting. Prior user rights are all about manufacturing and incenting innovators to manufacture here in the U.S., enabling them to go on and manufacture without having a cloud brought on later by a late filed patent right.

So, prior user rights relative to areas that are heavily affected by patents, where there is a large quantity of patents over a specific technology, will help manufacturers to be able to make rational decisions about what inventions they file patent applications on and where they stop filing patent applications with the assurance that they will still be able to manufacture their products and won't have someone coming in with a paper patent or any other kind of patent later on and shutting them down.

Mr. QUAYLE. Okay, thanks.

I want to go back to what the Chairman was talking about in terms of the 1-year approach and the possible switch to the substantial preparation test that you were mentioning. And I was just wondering if that actually leads to more subjective rulings on this?

Because the 1-year is very hard and fast whereas the substantial preparation leads to more subjectivity and could possibly lead to more uncertainty or at least less certainty. How do you envision the substantial preparation test alleviating those concerns?

Mr. KAPPOS. Well, I would say you are making a fair point that there is some subjectivity in a substantial preparation test. It would have to be defined and then ultimately there would be some litigation, no doubt, over what level of preparation is substantial.

Mr. QUAYLE. Okay. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Mr. GOODLATTE. The gentlewoman from California, Ms. Chu, is recognized for 5 minutes.

Ms. CHU. Thank you, Mr. Chair. Mr. Chair, thank you for having a hearing today.

I raised the issue of prior user rights during two of our hearings last year, and I am glad that there is some interest on the part of the Committee on examining the issue further. Many commentators in the patent community have interpreted the PTO's report as supporting expansion of prior user rights.

Would you agree with this characterization? And, if so, how should such an expansion be pursued?

Mr. KAPPOS. Well, thanks for the question. So, our report supports the expansion that Congress made in the AIA. We state, I think it is fair to say quite clearly, that the law does not need to be expanded further at the present time.

Ms. CHU. Do you see any need for the future? In the long term?

Mr. KAPPOS. Well, we do see a few issues that have been raised that need to be followed carefully.

As I mentioned, the fact that substantial preparation is not included, the 1-year look back period, and since some language that is less than clear defining or distinguishing between processes and products and articles of manufacture—those three items certainly should be watched closely, and could be the subject of appropriate legislation in the future.

Ms. CHU. Okay. I would also like to ask about your statements regarding the impact of prior user rights on manufacturing jobs. In your testimony, you stated that a prior user rights defense is pro-manufacturing and pro-jobs as it rewards businesses that put new technology promptly into commercial use.

Could you further explain the statement, and discuss the role that that prior user's rights defense plays in preserving manufacturing jobs.

Mr. KAPPOS. Well, sure. I would be happy to. I will give two scenarios, if that is okay.

The first one is simply a U.S. innovator that puts a new product on the marketplace, goes through the work of establishing a manufacturing line, all of the effort and investment associated with that, and then is years later accused of infringing a patent based on a patent application that was filed much later than that manufacturer went into production. It is an inequity, I believe, in the system for an early inventor to be presented with a later patent, and very economically inefficient to take the risk of having to shut down a manufacturing line and potentially put out of work all of the Americans who are working on that line.

And that leads to the second example—our trading partners have prior user rights, which means that their nationals in their countries are protected against third parties, including Americans, coming in and accusing their nationals of patent infringement for manufacturing in their countries.

So the system that we had before AIA was, in my view, substantially inequitable to our country and quite risky because it presented the situation where an inventor, an innovator, including an American one, was incentivized to establish their manufacturing line overseas where they would get the benefit of prior user protection and not in the U.S. because they would have the risk here of having to shut down a manufacturing line later on. Fortunately, that has been substantially corrected by the AIA.

Ms. CHU. And I would like to also ask about the impact of prior user rights on innovation. Your report indicated on page 31 that the public commented the Federal Register was not consistent concerning the innovation impacts of allowing a prior user defense.

What were some of the factors that the PTO considered when trying to ascertain the impact of the prior user defense on innovation rates?

Mr. KAPPOS. Well, we were looking for comments from the public including examples, if there were any. And the U.S., of course, had a prior user right from 1836 until 1952. We weren't able to find any evidence during that period of time including during expansions like the advent of electricity and the pharmaceutical industry as well as many other breakthrough innovations in U.S. industries that were created, some of which rely more on trade secrets, some of which rely more on patents, all of which seemed to thrive during that period of unprecedented growth.

So you take that economic history, you take the fact that we received quite a few comments and testimony with no evidence submitted that would indicate that there was a negative effect on innovation, so we are just simply not able to say that there is any evidence of any problem in prior user rights.

Ms. CHU. Thank you.

I yield back.

Mr. GOODLATTE. I thank the gentlewoman.

The Chair now recognizes the gentleman from California, Mr. Issa, for 5 minutes.

Mr. ISSA. I thank the Chairman.

Good to see you again. I think you are bringing us a very good point that ultimately all of us who supported patent reform have been concerned about. We were asked to work on essentially harmonization. If I hear you correctly, and review the record correctly, we missed harmonization in this one area, didn't we, by having a disparity in prior user rights between much of the world and ourselves?

Mr. KAPPOS. Well, I would say we made a lot of progress toward harmonization, but in the ways we have discussed here this morning, we didn't completely harmonize prior user rights.

If it is okay, Mr. Issa——

Mr. ISSA. Of course.

Mr. KAPPOS. One other comment I would make in that regard is that the exception of universities and tech transfer offices associated with universities is another area in which we did not harmonize our prior user rights provision.

I believe we did exactly the right thing, and I would recommend we not try to harmonize with any other country in that regard.

I believe that the excepting of universities and their breakthrough innovations is 21st century practice—21st century best practice—and I think the U.S. has leapfrogged the rest of the world in that regard.

So, yes we want to harmonize, but only on best practices, and that particular one is one where I would not advise harmonizing.

Mr. ISSA. So, as we consider legislation that might, if you will, correct or bring about a small change here—substantial but still technical change.

I wanted to follow up with one area—trade secrets. Ultimately, how do we, in your opinion, take someone who has reduced to practice something, has not gone to the Patent Office, but is keeping it secret versus—or choosing not to bring it to market—versus

somebody who is reducing to practice and simply doesn't run to the Patent Office?

How do we make sure that we get it right, that we are not encouraging, if you will, public disclosure to be withheld because they are going to maintain their prior rights.

If somebody today figures out how to make the Coca-Cola secret recipe, it is not patentable. If somebody were to, if you will, know that they had something but not want the world to know, not want the clock to tick, but then as soon as there is a patent granted says, "Hey, I have been doing this for 5 years." How do we balance that act if we bring new legislation?

Mr. KAPPOS. Right. So that is a great question. That is really the question at the crux of the balance between a trade secret regime and a patent regime, and prior user rights are designed to relieve some of that tension.

Mr. ISSA. And if someone patents out from underneath me, it wasn't a trade secret, I was just about to disclose it, I am sure.

Mr. KAPPOS. Well, there is that. That is right.

I would also say, though, that there are so many incentives to file patent applications that the USPTO has discovered well over a half a million times last year—a 5-percent growth rate in patent filings.

So, folks know how to file patent applications. There are lots of great incentives to file them, and there are lots of risks built into the system for those who retain trade secrets and don't disclose their inventions.

As you point out, Mr. Issa, the challenge for the folks at Coke is if someone is able to reverse-engineer their trade secret, they are out of luck forever, right? And if you get a patent, on the other hand, you have at least got some ability to have——

Mr. ISSA. But they have enjoyed a century by keeping it a secret. How do we make sure that no one enjoys the ability to deny somebody else exclusivity when in fact they did discover it?

Let's just say two entities discover it, roughly the same time. A year later, a patent is filed by one. The other has taken no action. We would generally say that is a prior use, depending upon how far along they were.

But let's say it is 3 years or 4 years, where do we divine the difference of somebody simply not intending to give we the public what the patent law was intended to. You know, we reimburse them, but we reimburse them with this exclusivity for a reason. And that reason is we get the benefit in those twenty or so years down the road.

How do we make sure we get that balance because I want to see the legislation tweaked, but I want to make sure that we don't induce people to have it both ways.

Mr. KAPPOS. Right. Well, key to that balance is ensuring that there is a manufacturing requirement. This gets back to the question of substantial preparations.

What you certainly don't want is to incent people to create inventions, retain them indefinitely as trade secrets, do nothing with them, and then later still have lots of options open including a prior user kind of option.

And the way you do that is to have some time limit. Right now, the AIA has the 1-year time limit. Could it be a little bit shorter? Well, we have discussed that. You know, it could, but that is a very close question relative to the needs of the universities.

I certainly would not recommend making it any longer. I think then you do tend to shift the balance in a direction that incentivizes people to sit on their rights, hold secrets, not disclose them, not enrich the corpus of knowledge, and then knowing that they can later still in effect have their cake and eat it too.

Mr. ISSA. I thank you, Mr. Chairman. Thank you for the indulgence of the time. I yield back.

Mr. GOODLATTE. I thank the gentleman.

The gentlewoman from California, Ms. Sánchez, is recognized for 5 minutes.

Ms. SÁNCHEZ. Thank you, Mr. Chairman.

Director Kappos, in your written testimony you stated that a prior use right defense is good for small business, and you just detailed earlier how it might be beneficial to manufacturing, but I am wondering if you can go into more detail about why, for example, small businesses, small businessman in my district, should be happy that this was included in AIA, and does that particularly, or I should say, specifically apply to manufacturing or other areas as well?

Mr. KAPPOS. Right. Well, that is a great question.

And I think it does. So for small businesses in my home state of California, where my entire family still lives, and all other states in the U.S.—one thing about small businesses is they all want to get bigger. They all share that in common. And the way you do that is—the way you grow as a small business is you have to put product or service out in the marketplace. You either do that through licensing someone to manufacture for you or you do it by developing manufacturing capability yourself.

We want to promote both of those kinds of activities. For a small business, which has hard decisions to make about patent filings, typically will be able to afford some level of patent protection, but will have to decide at some point, do I file a patent on that next incremental innovation? Or do I just stop it, and spend my incremental resources going out into the marketplace and manufacturing?

Those are the firms that are the most vulnerable to the situation where someone later comes in with a patent and stops them from growing, stops them from hiring more people, stops them from manufacturing. They don't have the resources to file for potentially the hundreds or thousands of patents that cover the entire manufacturing process, but they are totally dependent on the entire process step to step, or step by step to the end, to get their product into the marketplace.

So, the prior user right, while I believe beneficial to manufacturers generally, is extremely helpful to growing small businesses that are trying to put product into the marketplace.

Ms. SÁNCHEZ. Great. Thank you for that answer.

The only other question I have for you is, how do you expect—or how often would you expect or can you even predict that the prior use defense might be invoked prospectively?

Mr. KAPPOS. Yes. So, that is another great question. And we point out in our study that it is not heavily used in other countries that have it. We surveyed quite a few countries in Europe, Asia, you know, further north in North America here, in Canada. It is a lightly used defense.

That being said, I believe that the prior user rights defense remains an important defense. The fact that it is lightly used does not mean it is unimportant, first of all. And the reason I say that is because where it is used, it is in those critical situations where you have Americans' jobs at stake on a manufacturing line that otherwise could get shut down. You want a fail-safe defense like that for those situations.

The second point I would make is that the prior user defense is also used in a pre-litigation context, and it is harder to study those situations because they don't frequently get reported.

But it comes up, my experience, I would say regularly, perhaps not frequently, but regularly in contexts of licensing patents in patent portfolios between companies of various sizes where you will find either as a manufacturer or as a patentee that someone else has a piece of property out there or has a manufacturing line, a product in the marketplace such that the prior user right will cause you as the manufacturer to correspond with the patentee saying, "Look, you know, you shouldn't bother with me because I had this thing in the marketplace."

And that winds up being a litigation that never happened. Therefore, a report that never occurred, wasted resources that never had to be wasted, and all upside for our economy. Happens on both sides of the equations. Patentees benefit from that and manufacturers do, too, all without going into a litigation context.

And I believe that it is that part of the iceberg, if you will, the consensual negotiations in an effort that is not wasted, that is an important part of prior user rights.

Ms. SÁNCHEZ. Great. Thank you for being so thorough with your answers, and I appreciate your testimony today.

I yield back.

Mr. GOODLATTE. Well, Director Kappos, I think that concludes our questions, and this has been very helpful. We appreciate your taking the time to come be with us and share your thoughts on where we stand on this issue.

And we also appreciate your ongoing hard work to implement the new patent reform laws and to improve our patent system.

Mr. KAPPOS. Chairman Goodlatte and Ranking Member Watt, thank you very much.

Mr. GOODLATTE. Thank you.

We will now move to our second distinguished panel of witnesses. Each of the witnesses' written statements will be entered into the record in its entirety, and I ask that each witness summarize their testimony in 5 minutes or less.

To help you stay within that time, there is a timing light on your table. When the light switches from green to yellow, you will have 1 minute to conclude your testimony. When the light turns red, it signals that the witness' 5 minutes have expired.

As is the custom of this Committee, before I introduce the witnesses I would like them to stand and be sworn.

[Witnesses sworn.]

Mr. GOODLATTE. Thank you very much, and please be seated.

Our first witness is Mr. Robert Armitage. Mr. Armitage serves as the Senior Vice President and General Counsel of Eli Lilly and Company.

Prior to this, he served as Chief Intellectual Property Counsel of the Upjohn Company, and was a partner in the Washington, D.C. office of Vinson and Elkins, LLP.

Mr. Armitage served as a past president of the Intellectual Property Law Association, and the Association of Corporate Patent Counsel.

Mr. Armitage received his bachelor's degree in physics and mathematics from Albion College, and his master's degree and law degree from the University of Michigan.

Our second witness is Mr. Dan Lang. Mr. Lang serves as Vice President of Intellectual Property and Deputy General Counsel at Cisco Systems.

Prior to this, he was a partner at the law firm of Ritter, Lang and Kaplan, and an associate at Townsend, Townsend and Crew.

Mr. Lang earned his master's degree in electrical engineering from Stanford University, and his law degree from the University of California at Berkeley.

Our third witness, Mr. John Vaughn. Dr. Vaughn serves as Executive Vice President of the Association of American Universities. He supervises all of the Association's policy and analysis work, and is responsible for areas of intellectual property, information technology, research libraries and scholarly communication, and international education.

Dr. Vaughn received his BA in psychology from Eastern Washington State College, and he received a Ph.D. in experimental psychology from the University of Minnesota. He was also awarded an NIH post-doctoral traineeship, and served as a post-doctoral fellow at Duke University.

Our fourth and final witness is Dennis Crouch. Professor Crouch is Associate Professor of Law at the University of Missouri School of Law.

Prior to joining the MU Law faculty, he was a patent attorney at McDonnell, Boehnen, Hulbert and Berghoff, LLP, and taught at Boston University Law School. Prior to law school, he worked as a research fellow at NASA's Glenn Research Center, and as a Peace Corps volunteer in Ghana.

Professor Crouch is the founder of Patently-O, one of the Nation's most widely read patent law blogs. Professor Crouch received his B.Sc. in mechanical engineering from Princeton University, and his J.D. from the University of Chicago Law School.

Welcome to you all, and we will begin with Mr. Armitage.

You may want to turn on your microphone there.

TESTIMONY OF ROBERT A. ARMITAGE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, ELI LILLY AND COMPANY

Mr. ARMITAGE. Thank you. Chairman Goodlatte, Ranking Member Watt——

Mr. GOODLATTE. Pull it closer to you as well.

Mr. ARMITAGE. Okay.

Mr. GOODLATTE. There you go.

Mr. ARMITAGE. I appreciate the opportunity to appear before the Subcommittee today to offer testimony on the provisions of the America Invents Act that address the so-called prior user defense.

The Subcommittee has before it already an excellent analysis of all aspects of this issue in the report prepared by the USPTO. My belief in a nutshell is that the Director's testimony you have just heard and the USPTO's report says almost everything that needs to be said about that issue.

That will not stop me, however, from using the remainder of my 5 minutes. This is an issue where the Members of the Subcommittee are well versed already given the work that led to the enactment of the America Invents Act.

One point that at least in my view can't be underscored enough is the magnificent bipartisan efforts by Members of this Subcommittee that led H.R. 1249 to becoming our Nation's new patent law.

Indeed, I would be remiss today if I didn't specifically cite your work, Mr. Chairman, and the work of Ranking Member Watt, and the work of your respective staffs in putting together the provisions of this bill that made it the first 21st century patent law anywhere in the world, something we can be proud of as a country.

Let me move on to the prior user right defense. My own experience as a practicing patent attorney has taught me that a strong patent system is one that carefully balances the scope of protection afforded to worthy inventions, and also takes account of the residual rights that ought to remain in the public domain. An effective patent system both provides rights to patent holders and limits the reach of those rights.

One of the balancing points in an effective patent system is a prior user defense. It arises in the very rare circumstance where someone has commercialized an invention domestically without taking out a patent, and a competitor in that very same field has created the very same technology independently, and then subsequently sought a patent on the already commercialized technology.

In that case, who should have superior rights under the patent law? Should it be the prior domestic user, the commercializer who has created the new technology being able to trump the patent owner who subsequently then was able to share a patent?

I think in those rare circumstances, Congress has provided a clear-cut answer in almost every situation that arises under the law. Someone who is a prior commercializer of new technology almost always creates prior art that prevents a subsequently sought patent from being secured or if it is secured from being found valid in the court.

They are only, therefore, the rarest of circumstances where prior commercialization in the United States does not invalidate a subsequently sought patent. And that is when the new technology that has been developed is maintained and used as a trade secret.

And in this situation, Congress has said to the patent owner, yes, you can have a valid patent, but there's a proviso. Where the patented invention has been previously commercialized, the person who invested in that prior commercialization in this country, who created manufacturing facilities in this country, who hired workers

in this country, is given the ability to continue to undertake those commercial activities.

In other words, it is that balance that is always needed in an effective patent system if it is an effective one between patent owner rights and the rights of the public to continue to practice an invention. And indeed, I suspect that most Americans, if asked to examine these provisions in the America Invents Act, would say Congress chose to tilt the balance in favor of the patent owner to be able to bar any one of 300 million Americans from practicing the patented invention save for one person who was already in prior commercial use of the invention.

Moreover, I think that what Congress did in the America Invents Act actually makes the trade secret system we have in this country and the patent system both operate with optimal effectiveness.

My written testimony suggests three areas where this statute might be improved. I think you have already discussed those in the panel you had earlier with Director Kappos. My hope is that there can be a consensus developed on the desirability of further improvements to the America Invents Act, and in fact, it was the willingness to compromise and find consensus that led to the enactment of the law after a 6-year legislative effort.

We have at the table with me today, two individuals who were right at the forefront of forging compromise and consensus: Dave Lang and John Vaughn. And, frankly, without them and the productive engagement of the American Association of Universities and Cisco, the entities they represent here today, there would have been no America Invents Act.

Thus I am eager to hear their views on how we might work together to take this great achievement in reforming U.S. patent law, and make it an even greater one.

Thank you.

[The prepared statement of Mr. Armitage follows:]

Statement of
Robert A. Armitage
Senior Vice President and General Counsel
Eli Lilly and Company, Indianapolis, Indiana

Before

The United States House of Representatives
Subcommittee on Intellectual Property,
Competition and the Internet of the
Committee on the Judiciary

On

"Prior User Rights:
Strengthening U.S. Manufacturing and Innovation"

Wednesday
February 1, 2012

Chairman Smith, Ranking Member Conyers, and Members of the Subcommittee:

Mr. Chairman and Ranking Member Conyers, my name is Robert Armitage. Most of my four decades of professional experience has been as a patent lawyer. I served several years as general patent counsel at Lilly before becoming Lilly's general counsel in 2003. Prior to joining Lilly, I was a partner at Vinson & Elkins engaged in the practice of patent law. For the preceding 20 years I worked as a patent attorney and then as chief patent counsel for The Upjohn Company in Kalamazoo, Michigan.

During these past four decades, I have represented individual inventors, small businesses and universities, as well as multinational corporations. I have worked with clients seeking to stop infringement on their patent rights, as well as clients engaged in defending against allegations of patent infringement. Most of my career, however, has been as an advocate for a strong patent system. I have done so for good reason. For the last three decades, enforceable patent rights have been the core of the business model that allows companies such as Lilly to invest in the creation of new medicines.

I have also served in a variety of leadership positions over the past three decades in bar and industry trade associations. Currently, I serve as chair of the Section on Intellectual Property Law of the American Bar Association. These positions have afforded me the opportunity to work for improvements in the operation of the U.S. patent system.

The heart of a strong and effective patent system lies in crafting an appropriate balance between the need for effective protection of meritorious inventions and the need for limits on the reach of a patent, whether such limits be directed to the term of protection, the scope of protection, or the acts and circumstances constituting an infringement on the patent rights.

One long-term focus of my efforts has been to assure that the United States recognizes, in a fair, balanced and effective manner a "prior user" defense to patent infringement. I first proposed changing U.S. patent law to recognize rights based on prior use in 1982, as part of a wider ranging proposal, urging a coordinated set of reforms to U.S. patent law, including adoption of the first-inventor-to-file principle found in the Leahy-Smith Act.[1]

Thus, it is an honor for me to again appear before this Committee, especially given the profound accomplishment of this Committee earlier in this Congress in leading the effort to bring the Leahy-Smith America Invents Act into being. The historic,

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[1] See Robert A. Armitage, "*Reform of the Law on Interference: A New Role for an Ancient Institution in the Context of a First-to-File System*," Journal of the Patent Office Society, December 1982, pp. 663-698. This paper laid out the case for adopting the first-inventor-to-file principle as part of reforms providing mandatory publication of patent applications at 18 months from initial filing and a patent term that provided patents would expire at 20 years from the initial patent filing. This paper was based on work undertaken as Patent Interference Committee chair for the American Intellectual Property Law Association, then the American Patent Law Association.

perhaps global, significance of this new patent law is difficult to overestimate. In the immediate aftermath of its enactment, I noted that:

> The Leahy-Smith America Invents Act, the world's first truly twenty-first century patent act, contains all the elements needed for a patent system to operate effectively, efficiently, economically, and equitably. If the decade ahead yields greater international patent cooperation and harmonization among patent systems around the world, the starting point for that effort should lie in the incorporation of its provisions into patent laws across the globe."[2]

Among the notable accomplishments of the Leahy-Smith Act was to expand the defense to infringement that is available to persons who have commercialized in an invention before a competitor has sought to patent the invention. This provision by itself, even without any of the other reforms contained in the Leahy-Smith Act, represented a major improvement to U.S. patent law. This provision of law will act to protect American manufacturing jobs and U.S. innovators.

The Prior User Defense and Its Two-Decade Gestation

I first had the opportunity to testify in support of a "prior user defense" nearly 20 years ago, when a joint House-Senate hearing was held on the "Patent System Harmonization Act of 1992." At that hearing, I appeared on behalf of the National Association of Manufacturers, as chair of its Intellectual Property Committee. The thrust of the hearing centered on the advisability of moving forward with a first-inventor-to-file system in the United States. One important aspect of my 1992 testimony included the following observations on the desirability of a defense to infringement based on prior domestic commercialization, which I firmly believe to be as valid today as it was during my testimony then:

> Prior user rights represent an important and essential feature of this legislation. These rights are needed to assure that investments in U.S. manufacturing facilities are not compromised by later-filed patents. Without prior user rights, the United States would be at a competitive disadvantage in attracting investment in new manufacturing facilities relative to other industrialized countries, all of which recognize such rights.[3]

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[2]Robert A. Armitage, "LEAHY-SMITH AMERICA INVENTS ACT: WILL IT BE THE NATION'S MOST SIGNIFICANT PATENT ACT SINCE 1790?", Washington Legal Foundation Legal Backgrounder, Vol. 26, No. 21 (September 23, 2011), available at: http://www.wlf.org/Upload/legalstudies/legalbackgrounder/09-23-11Armitage_LegalBackgrounder.pdf.

[3] Joint Hearing Before the Subcommittee on Patents, Copyrights and Trademarks of the Senate Committee on the Judiciary and the Subcommittee on Intellectual Property and Judicial Administration of the House Committee on the Judiciary, 102nd Congress, Second Session, on S. 2605 and H.R. 4978, April 30, 1992, S.N. J-102-57 (Senate) and S.N. 122 (House), p. 190.

I had the privilege on October 26, 1995 of returning here to testify again on the issue of a prior-user defense during my tenure as the president of the American Intellectual Property Law Association. The subject of the 1995 hearing was exclusively focused on the Prior Domestic Commercial User Rights Act, H.R. 2235, 104th Congress.

The position of the AIPLA was that the United States should change its patent laws to include a prior commercial user defense, even if the United States did not (as Congress has now done under the Leahy-Smith Act), enact the first-inventor-to-file principle into U.S. patent law. On the merits of a prior user defense, my testimony was crystal-clear:

> The American Intellectual Property Law Association has long supported the introduction of "prior user rights" into the U.S. patent laws. During the 102nd Congress AIPLA endorsed prior user rights in the context of adopting a so-called "first-to-file" system as part of a proposed Patent Law Treaty, we subsequently supported legislation in the 103rd Congress that would have introduced a form of prior user rights into our current patent law, and, today, we are pleased to support the H.R. 2235 as introduced in the 104th Congress.
>
> The sum and substance of our support can be captured in a few words: fairness and balance. Our threshold requirement for support of any proposal for prior user rights is that it maintain adequate and effective exclusivity for the patent owner. H.R. 2235 was carefully constructed to assure that patents, and the full incentives under the patent system, will remain essentially undiminished. We further regard H.R. 2235 as embodying a simple idea of fairness: if in good faith a domestic manufacturer has made an investment in plant and equipment – and employment of American workers – patents applied for after commercial use has begun should not affect such a prior commercial user. Finally, the provisions of H.R. 2235 assure balance between the right to continue in commerce and the underlying patent right.[4]

The decoupling of AIPLA's support for a prior user defense from a first-inventor-to-file transition as far back as 1995 was tied to a fundamental change to the U.S. patent system enacted as part of the Uruguay Round Agreements of 1994. *The United States*

[4] Statement of Robert A. Armitage, President, American Intellectual Property Law Association before the Subcommittee on the Courts and Intellectual Property of the Committee on the Judiciary, 104th Congress, First Session, on H.R. 2235 (Prior Domestic Commercial Use Act of 1995), October 26, 1995. Testimony is attached as Appendix A.

committed itself, beginning in 1996, to recognizing foreign-origin invention proofs in all proceedings before the Patent and Trademark Office and the courts – thus, no longer limiting such proofs to activities that had taken place in the United States. The increased ability of foreign-origin patent applicants to secure and defend patents directed to shutting down manufacturing activities conducted in the United States led to AIPLA's call for a level playing field – giving U.S. manufacturers the same type of defense against patent infringement charges from foreign-based competitors as the foreign-based competitors have when charged with patent infringement by U.S. manufacturers.

My most recent testimony touching on prior user rights was in April 2006, during the early days of the legislative effort that produced the Leahy-Smith Act. In that testimony, on behalf of Eli Lilly and Company, I noted that a comprehensive effort at U.S. patent reform should:

> *Expand the right of a prior inventor who commercializes an invention in the United States to continue using the invention, even if someone else subsequently seeks and obtains a patent on that invention.* Patent owners today can seek and enforce patents on technology that another inventor is ready to place or has already placed into commercial use in the United States. "Prior user rights" reforms afford such inventors, as well as those that they authorize to work their inventions, an expanded defense to infringement that can allow these commercial users (including those who have completed substantial preparations for commercial use) to commence or continue that use without liability to the patent owner.[5]

The case for an effective and balanced provision dealing with infringement charges leveled against a "prior user," more specifically a prior domestic commercial user, remains undiminished. Indeed, in an era when U.S.-based manufacturers are increasingly challenged by foreign-based competitors, protecting the prior domestic commercial user from charges that subsequently-sought patents can infringe such a previously-established commercial effort has never been more compelling. A strong "prior user" defense acts to support American manufacturing jobs.

The "Prior User" Defense Under the Leahy-Smith Act Was a Fair and Balanced Provision Addressing the Competing Interests Of the Prior Domestic Commercial User of an Invention and the Owner of a Subsequently-Filed Patent on the Invention

Across the globe, patent systems provide – and have long provided – "prior user" defenses. Under a typical such defense, a person who has engaged in commercial activities in a particular country gains immunity from infringement under that country's domestic patent laws, but only if the patent that issued in that country was *originally*

[5] Hearing Before the Subcommittee on the Courts, Internet and Intellectual Property of the Committee on the Judiciary, 110th Congress, Second Session, on H.R. 2795, April 27, 2006.

sought after the accused infringer's domestic commercialization commenced. Indeed, as the defense exists in its most effective form, the completion of any substantial preparation for commercialization is all that is needed to secure such immunity from subsequently-sought patents. Moreover, as the defense is most effectively implemented under foreign laws, the defense exists irrespective of the nature of the patent or type of patent claim that forms the basis for the allegation of infringement.

Because of the inherently limited nature of a balanced and effective defense, it *potentially* impacts only a *tiny percentage* of patents. Thus, an effective "prior user" defense never materially impairs the overall strength and effectiveness of the patent system as a whole.

What constrains the operation of the defense such that the overwhelming majority of patents that issue can never be subject to the defense?

First, for almost all patents that are granted, the patented inventions have not yet been commercialized – by anyone – at the time the patent for the invention is initially sought. Thus, the threshold requirement for asserting the defense, that there has been a *prior domestic commercial use*, cannot be satisfied.

A prior user defense cannot arise except in situations where the patented invention has been independently created by at least two persons – the inventor/patent owner and the accused infringer/prior commercializer. Thus, the number of patents where one person will have developed an invention for commercialization without seeking a patent and a second person will have independently developed the same invention and then subsequently sought to patent the invention *is at most some small fraction of one percent of all patents issuing*.

Second, in most cases where there is a potential conflict between prior domestic commercialization and a later-sought patent, the defense never needs to be asserted. Why? In the vast majority of situations where this type of contemporaneous, independent development and commercialization has taken place, the prior user's prior commercialization activities will result in a prior *public* disclosure of the patented invention.

In these situations the prior user defense will be secondary to a patent invalidity defense. For example, whenever an invention is *publicly accessible* under the new provisions of 35 U.S.C. §102(a)(1), the patent in question can be readily invalidated on this ground – no specific defense to its infringement is needed.

The upshot of all this, therefore, is that the defense at issue arises and has a substantive impact on a patent owner solely when prior *secret* domestic commercial activities qualifying for the defense fall within the realm of someone else's independent discovery of the same technology, for which a patent on behalf of the independent discoverer is subsequently sought and issued.

This necessary invalidity of a patent that arises from any "prior use" that is publicly accessible gives rise to an important corollary observation. Congress could simply have eliminated the need for a prior user defense to infringement altogether by providing in the patent statute that *any* prior domestic commercialization of a claimed invention by someone other than the patent owner would be sufficient by itself to constitute "prior art" to the later-sought patent. In that case, the activity in question would not constitute a "prior user" defense to infringement but a "prior art" defense to invalidity of the patent. Without validity, there can be no infringement and the invention becomes open for use by any member of the public.

Thus, any discussion about the fairness of the defense to the patent owner – and whether it appropriately balances the competing interests as between patent owner and an independent developer's prior commercialization of the patented subject matter – needs to consider that Congress stepped back from enacting a provision mandating that a patent would be invalid if a prior commercial use could be established. Instead, it prescribed a vastly more limited consequence. In the case of a prior domestic commercial use, the patent remains valid, but the prior user itself is accorded a personal defense to infringement.

Viewed in this light, is the "prior user" defense an ill-considered derogation from what should be "exclusive rights" accorded the patent owner? Does less than perfect exclusivity for the inventor make the provision constitutionally suspect? Is the defense some new and undesirable form of "compulsory license"?

It is difficult to answer any of these questions in the affirmative knowing that Congress would have been clearly within its authority under the Constitution to simply prescribe that a patent cannot be valid if the patented invention had already been commercialized domestically by a rival inventor before the patent was sought.

Indeed, it can hardly be argued that there are compelling, much less absolute, equities in favor of declaring that an invention may be validly patented, and entitled to categorically exclusive rights, if a competitor had already made the invention independently and then took steps to place the invention into domestic commercial use before the patent for the invention was originally sought. As an example, for more than a century, Congress provided that a prior domestic invention (whether or not placed into a prior commercial use) was all that was required to create "prior art" to invalidate a later-sought patent of a foreign-based inventor directed to the invention.[6]

Thus, it is in light of this congressional forbearance, in declaring that only when commercialization has rendered a patented invention publicly accessible that the patent must be regarded as invalid, that the fairness of the "prior user" provision in the Leahy-Smith Act to patent owners must be judged.

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[6] The United States was forced to abandon this ground for invalidating patents held by foreign-based inventors only when the Uruguay Round Agreements Act of 1994 took effect, bringing the United States into compliance with its obligations under the TRIPs agreement.

As the balancing point between the competing interest of prior domestic commercial user and subsequently-filing patent owner, Congress wisely chose to sustain the validity of the patent, but afford a personal infringement defense to the prior user. The "public accessibility" standard that will limit patent-invalidating "prior art," *i.e.*, under the "otherwise available to the public" limitation found in new §102(a)(1) of the patent statute, was universally supported within the patent bar and among other proponents of the Leahy-Smith Act, notably the Coalition for 21st Century Patent Reform.

The "public accessibility" standard provides inventors a high degree of assurance that their patents, once secured, are valid ones because of the transparency of the standard. If subject matter cannot be found from sources available to the public, the validity of the patent cannot be attacked on grounds of lack of novelty or obviousness. However, just because the patent is valid, notwithstanding the prior domestic commercialization by a competitor, cannot mean that Congress did not act both wisely and appropriately by providing that a prior use can provide the prior user itself a defense to infringement of a patent that Congress clearly could have – but did not – decree to be an invalid one.

In the final analysis, those in the patent-owning community who have spoken out against the Leahy-Smith Act's "prior user" defense on the ground that patent owners ought to have pristine "exclusive rights," or that such a defense amounts to a "compulsory license," certainly would not wish to see their arguments in this respect wholly demolished by having Congress amend the limiting phrase "or otherwise available to the public" in the new patent statute amended to read, "whether or not available to the public." This final observation, for the vast majority of the patent-holding community, suffices to explain the widespread support for the "prior user" defense as a fair and balanced exercise of congressional authority.

The Prior User Defense Supports the Public Policy of Affording Domestic Manufacturers Competitive Advantages Available Through Trade Secret Protection and Supports U.S. Manufacturing Jobs

Companies that make the decision to establish manufacturing facilities in the United States typically face many competitive challenges. For one, they often compete against firms operating foreign-based facilities. U.S. wage and benefit costs may be greater. U.S. environment regulations may be more stringent. Key suppliers and important sources of raw materials may be located offshore – within easier reach of their foreign-based competition.

These competitive challenges can be offset, in some substantial measure, because the United States maintains strong, effective intellectual property protection. We strive for a strong patent system in which valid patents can be effectively enforced. The Leahy-Smith Act, once fully implemented, will greatly improve the prospect that a valid patent can be successfully enforced.

Similarly, the availability of trade secret protection and the ability to seek judicial redress for misappropriation of trade secrets are of vital importance. Maintaining certain types of manufacturing technology as trade secrets can afford U.S.-based manufacturers competitive advantages over foreign-based producers. The competitive advantages from trade secret protection can make it feasible to locate facilities in the United States that might otherwise be more economic to operate outside the United States. Technology is maintained as a trade secret in an array of circumstances where the alternative of seeking patent protection would not simply be futile, but would be affirmatively counterproductive.

Why so?

Patenting technology means making the technology publicly available to competitors globally. Indeed, it means making the technology *freely available* to competitors throughout the world *unless* global patents on the technology can be successfully sought, secured, and enforced.

In some key markets, patents are very difficult and very expensive to enforce. In some situations, the available patent protection is very narrow and easy for a competitor to circumvent. Finally, many trade secrets are incremental – represented by an array of separate, small advantages that would require an unaffordable multiplicity of patents – sought globally – to even attempt to protect.

When patent protection is unavailable, limited in scope, or uneconomic to secure, the only option for protection of competitively valuable technology is maintaining the technology as a trade secret. It becomes, thus, a public policy imperative not just to secure the viability of trade secret protection, but to make certain that protecting technology through trade secrets is not unduly frustrated. A potential source of frustration arises if trade secret technology that has been engineered into a new plant that is headed into commercialization operation, or already in commercial use, can be frustrated by belatedly sought patents.

Is it good public policy to secure for domestic manufacturers the ability to practice new technology in secret?

A few commentators have suggested that an effective, balanced prior user defense is bad public policy because it can unduly encourage secrecy in preference to public disclosure of important new technology. In my view, they are both wrong as a matter of good policy and wrong as a matter of good economics for the United States.

Any policy perspective that would encourage public disclosure at the expense of securing trade secrecy, whatever possible theoretical merit, should carefully weigh the practical impact. Investors seeking to locate new manufacturing facilities must weigh the advantages and disadvantage locating manufacturing activities domestically given the well-documented benefits from picking sites abroad.

A fair, balanced and effective prior user defense removes a competitive disadvantage to commercializing secret technology domestically, given the ready availability of such rights in foreign jurisdictions. In considering this provision, policymakers must take into account the positive benefits that accrue to American workers and U.S. economy by adopting policies that appropriately respect domestic manufacturing jobs and facilities undergirded by U.S. innovation. The advantages that foreign jurisdictions would have without an effective domestic "prior user" defense are worth detailing.

The Implications of an Effective Prior User Defense for U.S.-Based Manufacturers

A fair, balanced, and effective defense to infringement based upon a prior domestic commercial use has a collection of implications:

Prophylaxis Against Nefarious Use of the Patent System

Countries outside the United States have long recognized that not every global competitor in a particular market plays by the rules of high integrity at all times. Companies have been known to hire key employees from their competitors for the wrong reasons – in hopes of gaining access to the competitor's secrets that can then be exploited. Industrial espionage is not unknown as a means to the same end.

Companies operating facilities in the United States are not immune from such nefarious activities. The scientific and engineering talent at many U.S.-based manufacturing facilities is global talent. Key scientists and engineers may have been born in Europe, educated in Asia, and hired to work here in North America, before going off-shore to work for a competitor.

One provision of law that protects European-based and Asian-based manufacturers against the possibility that their commercially important trade secret technology might nefariously find its way into later-sought patents taken out by their foreign-based competitors (to then be asserted against them!) is the "prior user" defense. Simply placing the defense into the patent law renders efforts at this type of nefarious patenting futile.

This prophylaxis against a company's purloined trade secret technology being patented by someone else and asserted against it exists everywhere across the globe, except in the United States. The Leahy-Smith Act has a potential crucial deficiency in this regard. It allows technology thieves a 1-year "grace period" in which to complete their thievery and seek a patent on subject matter already in commercial use by someone else in the United States.

Simplification of Patent Clearance for New Technology

Another significant impact of affording a fair, balanced and effective "prior user" defense is its impact on due diligence efforts. Manufacturers making investments in the

millions to billions of dollars to construct a single manufacturing plant that may employ hundreds to thousands of U.S. workers need to assure that the technology to be employed in the plant is free from infringement of its competitors' patents. The due diligence process needed to arrive at that conclusion is simplified if an effective "prior user" defense is in place.

As new technology is examined to determine if it can be commercialized or its commercialization can legally continue, the availability of a "prior user" defense means that patents sought after commercialization has begun – or substantial efforts to commercialize have been completed – need not be reviewed or considered. It means that, once a new plant is in operation, further such due diligence efforts are unnecessary.

In a similar vein, an effective "prior user" defense is especially attractive for smaller enterprises that have established commercial activity and are seeking new investors or new financing. A patent attorney's due diligence report provided to a possible investor need not consider patents sought post-commercialization and, moreover, can be clear that no new patents can impact the enterprise's freedom to operate. Less "patent risk" means greater security that the investment will not be futile and lower financing or borrowing costs to see it to completion.

Discourages Efforts to Patent Technology Best Kept Secret

A public benefit of effective laws against misappropriation of trade secret technology, coupled with an effective "prior user" defense to infringement to protect the trade secret holder should a competitor secure a patent on the trade secret technology, is that overuse of the patent system is affirmatively discouraged.

For technology where trade secret protection provides the greatest competitive advantage for the creator of the technology, it makes little policy sense to compromise the effectiveness of trade secret protection by drafting the patent laws to create a potential conflict with the commercialization of the trade secret. Indeed, if the conflict with the patent system could only be resolved by foregoing trade secret protection, in favor of making use of the patent system, the result would be protection for the investor in commercialization that, in virtually every circumstance, would be far inferior to trade secret protection. In this situation, two unfortunate consequences emerge.

First, the creator of the new technology forced into the patent system has vastly increased costs to secure protection, and then run the risk that the inability to enforce its patents would amount to a give-away of the competitive advantages it hoped to secure through its use of the new technology.

Second, the USPTO is obliged to devote resources to the examination of these patent applications, rather than focus its work on inventions where a prompt, high-quality patent examination is integral to bringing a new product or service to market – indeed, securing a patent that may be essential to securing the investments needed to develop the product to the point of commercialization.

Employing the patent system for inventions where patents are important to commercialization, and making the investments needed to secure commercial development, represents its highest and best use. Using trade secret protection for discoveries ill suited to effective patenting, and for which securing competitive advantages best comes from protecting that secrecy, is the *raison d'être* for the law of trade secret misappropriation. An effective "prior user" defense allows each of these two intellectual property regimes to operate at its best in the public interest.

Conclusions

The Committees on the Judiciary of the House and the Senate should take justifiable pride in shepherding an historic patent reform bill through Congress. One of the significant achievements in that legislation was the reform of the patent law as it related to the "prior user" defense. In enacting this reform, it provided fair and balanced benefits for prior domestic commercial users of technology in the situation where competitors have subsequently sought and secured patents. With this historic achievement secured in U.S. law, Congress now has the opportunity to develop a consensus on three areas in the law that would benefit U.S.-based manufacturers: *opening the defense to patent claims of all types, eliminating the 1-year "hold back" period before the defense can be established, and permitting the completion of substantial preparations for commercialization to be a sufficient trigger for asserting the defense*. U.S. patent law should give those who choose the United States as the place to invest in manufacturing facilities – and creating jobs for American workers – the same immunity from charges of patent infringement that investors who create jobs here would enjoy had they instead invested in creating foreign-based manufacturing plants. Let's develop the consensus needed to get this done forthwith.

February 1, 2012
Indianapolis, Indiana

Appendix A

AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION
2001 JEFFERSON DAVIS HIGHWAY, SUITE 203, ARLINGTON VIRGINIA 22202-3694

STATEMENT OF

ROBERT A. ARMITAGE, PRESIDENT

AMERICAN INTELLECTUAL PROPERTY
LAW ASSOCIATION

FOR THE

SUBCOMMITTEE ON COURTS AND
INTELLECTUAL PROPERTY

COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

OCTOBER 26, 1995

ON THE

H.R. 2235, PRIOR DOMESTIC COMMERCIAL USE ACT OF 1995

Summary

The American Intellectual Property Law Association has long supported the introduction of "prior user rights" into the U.S. patent laws. During the 102nd Congress AIPLA endorsed prior user rights in the context of adopting a so-called "first-to-file" system as part of a proposed Patent Law Treaty, we subsequently supported legislation in the 103rd Congress that would have introduced a form of prior user rights into our current patent law, and, today, we are pleased to support the H.R. 2235 as introduced in the 104th Congress.

The sum and substance of our support can be captured in a few words: fairness and balance. Our threshold requirement for support of any proposal for prior user rights is that it maintain adequate and effective exclusivity for the patent owner. H.R. 2235 was carefully constructed to assure that patents, and the full incentives under the patent system, will remain essentially undiminished. We further regard H.R. 2235 as embodying a simple idea of fairness: if in good faith a domestic manufacturer has made an investment in plant and equipment — and employment of American workers — patents applied for *after* commercial use has begun should not affect such a prior commercial user. Finally, the provisions of H.R. 2235 assure balance between the right to continue in commerce and the underlying patent right. H.R. 2235 requires that the prior user be a prior inventor and limits the extent of the rights of a prior user based on the extent of the actual prior commercial activity.

Prior user rights exist under patent laws throughout the industrialized world and have long been an integral part of foreign patent systems. Experience with foreign prior user right provisions has demonstrated the following:

- *Prior user rights exist without significantly impacting on patent exclusivity.* Prior user rights typically derive from the use of secret manufacturing technology on which a subsequent inventor later seeks a patent. Such cases arise with relative infrequency. Moreover, the rights arising from a prior use only affect patents in the country in which the prior use was undertaken. Hence, they cannot undermine or provide disincentives for using the patent system.

- *Prior user rights tend to selectively protect established domestic industries against foreign patent owners.* All prior users are domestic prior users; most patent owners in most countries are foreign entities. The result is that prior user rights commonly operate in a "protectionist" mode. They represent a means for preventing mostly foreign-owned patents, filed after the public has the benefits of the invention, from stopping an established domestic manufacturer.

- *Prior user rights avoid a "give away" of valuable manufacturing technology.* Many patentable inventions cannot be economically patented; others, even if patented, cannot be effectively enforced. If prior commercial users are forced into seeking incomplete or ineffective patent protection, they simply forfeit their technology rights. U.S.-made technology will be copied abroad where patents are not in force or where they cannot be effectively enforced.

We support H.R. 2235 as a tailored, targeted legislative response to a real and pressing problem for the creators of new domestic technology, new American industries and new American jobs.

Mr. Chairman:

I appreciate the opportunity to appear before the Subcommittee today to present the position of the American Intellectual Property Law Association (AIPLA) on H.R. 2235, the "Prior Domestic Commercial Use Act of 1995."

The American Intellectual Property Law Association is a 9,400 member national bar association, whose membership primarily consists of lawyers in private and corporate practice, in government service, and in the academic community. The AIPLA represents a wide and diverse spectrum of individuals, companies and institutions involved directly or indirectly in the practice of patent, trademark, copyright, and unfair competition law, as well as other fields of law affecting intellectual property.

The AIPLA supports the enactment of H.R. 2235. This bill provides a carefully crafted defense right to a charge of patent infringement to a person who has made a good faith, commercial use of the subject matter of the patent, or effective and serious preparation for such use, prior to the earliest effective filing date of that patent. The Association supported similar legislation in the 103rd Congress. The bill which you have introduced for yourself and Mrs. Schroeder in this Congress contains a number of new provisions which even more carefully define the scope of the prior use defense, thereby ensuring that it will be available only in circumstances where the equities favoring a prior user over a later-filing patent owner are compelling.

Before addressing the details of H.R. 2235, I would like to offer a few comments to place the support of the AIPLA into the proper perspective.

Prior user rights are a common feature of patent laws outside the United States. Most foreign patent systems are deliberately structured to balance the protection afforded a prior domestic user with the rights granted under a subsequently filed patent. Under these systems, the commercial activities of a prior user cannot be used to invalidate a patent that is subsequently applied for and issued. Similarly, an established prior use cannot be stopped by an inventor who applies for a patent after the prior use is commenced. Prior user rights produce a "win-win" outcome in the sense of recognizing both the validity of the late-filed patent and continued viability of domestic investments in plant and equipment previously made in good faith.

In most countries, prior user rights have an undeniably "protectionist" function. Our major trading partners benefit from the prior user rights in their domestic patent laws because they assure that domestic manufacturers in those countries, but not foreign manufacturers, can qualify as "prior users." In most countries around the world, domestic inventors hold the minority — sometimes a tiny minority — of patents that are issued. Thus, a common situation in which the prior user right applies is to protect the investment of a domestic manufacturer against a foreign patentee.

Instead of this "win-win" outcome for both the inventor and the prior user, the current U.S. patent law provides the potential for a "lose-lose" situation for the domestic manufacturing company. First, the relative number of U.S. patents that are being granted to foreign-based inventors has steadily increased over the past several decades. Simple mathematics indicates that U.S. patents granted to foreign inventors may pose an increasing challenge to domestic manufacturing enterprises unless the U.S. recognizes prior user rights. The United States patent system, absent the adoption of prior user rights, can be expected to exhibit an increasingly

"reverse-protectionist" tilt against domestic manufacturing entities and in favor of foreign patentees.

Second, the GATT TRIPs legislation will shortly strengthen the hand of the foreign inventor in enforcing patents against U.S. manufacturing enterprises. Up until now, a foreign inventor who applied for a patent after the U.S. invention date of a prior domestic manufacturer could not enforce the patent against the domestic manufacturer (unless the invention was "abandoned, suppressed or concealed"). The Uruguay Round Agreements Act greatly complicates even this limited protection for a domestic manufacturer. Beginning on January 1, 1996, a foreign inventor will be able to rely on earlier foreign activities to counter any U.S. invention date proofs. Again, the reverse tilt in the U.S. patent law works against the domestic manufacturer by enhancing the enforceability of foreign patents.

While thirty years ago the arguments for a statutory "prior user" right in the U.S. patent law might have been made in trade-neutral terms, this is no longer the case. As the United States grants more patents to foreign-based inventors and enhances the enforceability of those patents against prior domestic manufacturers, the time has clearly come for Congress to act. We urge that the Congress recalibrate the balance between rights of the prior domestic user and rights afforded under a subsequently sought patent.

For the great majority of inventions, effective protection can only be realized through the patent system. While protection under trade secret law is available for certain manufacturing processes and equipment, most inventions cannot be protected effectively as trade secrets. They can be reverse engineered and copied once they are placed on the market or are otherwise publicly disclosed. Moreover, because trade secret laws generally provide no exclusivity of the

type available under patent law, protection under trade secret laws is seldom chosen where enforceable patent rights are readily and economically available.

There are a number of reasons, however, why it is not feasible or even possible to patent every invention which could be patented. First and foremost is the relationship between enforceability and cost. The costs of seeking and obtaining patent protection around the world are high. These costs, as well as the costs of enforcing patents country-by-country, have become so high that large U.S. companies must carefully prioritize which inventions they seek to patent. The burden imposed by such costs fall even more heavily on smaller U.S. firms, and especially on independent inventors, who are frequently limited to seeking to patent only their most important inventions.

Where patents on manufacturing technology cannot be obtained and enforced on a global basis, the effect of seeking limited protection in the United States is simply to give valuable U.S. technology to foreign companies for use where corresponding foreign patents were not obtained.

The practical inability of U.S. manufacturers to patent their manufacturing-related inventions globally because of these high costs constitutes no less than a free gift of technology for all of those inventions. Where only a U.S. patent is sought, it would fully disclose to competitors how to make the inventions—including the invention's "best mode"—and would permit competition with the innovator in the United States and in foreign markets.

Even if patents are sought and obtained, enforcement represents a second practical problem. Identifying a competitor's use of such a patented process can be extremely difficult in the United States and utterly impossible in foreign countries. Even in the case of products made abroad and later imported into the United States, it is very difficult to prove that the imported

products were made by a particular process that infringes a patent in the United States or the country of origin.

A prior user defense should prove especially useful for the computer software industry. Historically, many inventors have been dissuaded from seeking patents on computer-implemented inventions because of uncertainties over the availability of such patents. For example, the Patent and Trademark Office has only reluctantly accepted the patentability of many types of computer-implemented inventions. Instead of seeking patents, many inventors have relied on trade secret protection. Recently, however, the attitude of the Patent and Trademark Office appears to have changed. The Office has issued Proposed Examination Guidelines for Computer-Implemented Inventions that suggests that the door is now open to greater patent protection. A prior user right would assure that a legion of prior commercial users would not now be subject to newly filed and issued patents that are sought pursuant to the Office's new guidelines. Hence, during the expected transition to a greater reliance on patent protection, H.R. 2235 would serve an additional salutary purpose.

For these and other practical reasons, many U.S. companies and especially smaller U.S. companies are forced to forego patenting of many inventions. In the case of manufacturing-related technology, these companies seek to protect their technology under trade secret law. This creates the possibility that a second, later inventor may obtain a U.S. patent on technology already being commercially used, but which has not been publicly disclosed. This later-filing inventor could then obtain an injunction and prevent the U.S. manufacturer from further use of the

invention, even though the U.S. manufacturer had made the full benefits of the invention available to the American public through its commercial use of the invention.

Foreign inventors and manufacturers, though confronted with the same cost and enforceability problems as their American counterparts, have greater inherent flexibility. They do not face the possibility that a later-filing inventor can obtain a patent and disrupt their home-country based manufacturing operations. As noted earlier, this is because virtually all industrialized countries protect their domestic manufacturers with a prior user right (see Keith M. Kupferschmid, *Prior User Rights: The Inventor's Lottery Ticket*, 21 AIPLA Quarterly Journal No. 3 (1993).

Thus, while a Japanese or German company with a U.S. patent may preclude the use of an industrial process by a U.S. company which had been utilizing that process as a trade secret for years before the patent application for the process was even filed, the reverse is not the case. American inventors holding patents in any of our major trading partners could not preclude use of the patented invention by a company which had begun its use of the invention before the American inventor filed a patent application. When 45% of all U.S. patents are being granted to foreign firms, this unbalanced playing field is, of itself, a strong economic argument in support of H.R. 2235.

The laws of the United States should give weight to legitimate forms of protection for American jobs and businesses.

The AIPLA support of H.R. 2235 is predicated on the fact that it does not compromise effective protection for patent owners. The limitations of H.R. 2235 ensure that U.S. patentees will continue to enjoy their full, exclusive patent rights except in certain rare situations where an

earlier-started, domestic, commercial enterprise will be allowed to continue under restricted circumstances. We have every confidence that the proposed prior use defense cannot be easily abused or misused. This confidence stems from actual experience in other countries having prior user right provisions which are more readily available than those which would be established under H.R. 2235 (see Lise Osterborg, *Towards a Harmonized Prior User Right Within a Common Market System*, 12 Intl. Review Indus. Prop. and Copyright 447 (1981).

Unlike its predecessor in the 103rd Congress which provided a prior use defense to a person who commercially used, or made effective and serious preparation to use, a patented invention before its effective filing date, H.R. 2235 requires that the commercial use or a reduction to practice of the invention must occur more than one year before the effective filing date. The term "commercially used" means that a person asserting the prior user defense must have used the invention in the United States in the design, testing or production of a product or service which is sold or otherwise transferred in commerce. The invention used need not be accessible or otherwise known publicly. Thus an industrial process or tool which is used as a trade secret to produce a product in commerce would be deemed to have been commercially used.

H.R. 2235 also tightens the requirements with respect to what constitutes "effective and serious preparation." Under H.R. 2235, "effective and serious preparation" will only give rise to a prior use defense with respect to inventions which cannot be commercialized without a significant investment of time, money, and effort. This is further qualified by the requirements that a person asserting a prior use defense must have:

— reduced the invention to practice in the United States more than one year prior to the effective filing date of the patent;

— completed a significant portion of the total investment necessary to commercially use the invention and have made a commercial transaction in the United States in the preparation to use the invention prior to the effective filing date of the patent; and

— diligently completed the activities and investments necessary to commercially use the invention and promptly began its commercial use after the effective filing date of the patent.

Should the person asserting a prior use defense have abandoned commercial use of the invention, he or she can only rely on activities occurring after the effort to commercially use the invention is resumed.

There are a number of other limitations on the establishment of a prior use defense under H.R. 2235. First, the burden of proving that a person is entitled to the defense is always on the person asserting the defense. Should an infringer claiming the defense fail to demonstrate a reasonable basis for such assertion, the court shall award attorney's fees to the patentee.

Moreover, the prior use defense established by H.R. 2235 is not a general license under all of the claims of the patent in issue. It is a defense only to the claim or claims in the patent which the person asserting the defense had commercially used or made effective and serious preparations to use. An improvement by the prior user reduced to practice less than one year before the effective filing date of the patent that would infringe an additional specifically claimed subject matter would not benefit from a prior use defense. Only improvements that do not infringe additional claims and variations in the quantity or volume of the qualifying prior use would be permitted.

The prior use defense could not be licensed, assigned or transferred to a third party except in connection with the good faith assignment or transfer of the entire portion of the business to which the defense relates.

Finally, a person may not assert a prior user defense based on information that was derived from the patentee or those in privity with the patentee. Thus, if a patentee demonstrates that the person asserting a prior use defense had access to information from the patentee or reasonably could have obtained such information that likely accounted for the original acquisition of the invention by that person, then there would be a rebuttable presumption that the person derived the information and is not entitled to the defense. The person asserting the defense would have to establish that the invention was independently obtained from a source other than the patentee to rebut such a presumption.

In light of the need for a prior use defense to place American businesses on an equal footing with their foreign competitors, the AIPLA supports enactment of H.R. 2235 with its carefully crafted limitations and safeguards against abuse. Although the prior use defense of H.R. 2235 will seldom be available, we believe there is a need to establish it promptly.

Mr. GOODLATTE. Thank you, Mr. Armitage.
Mr. Lang, welcome.

TESTIMONY OF DAN LANG, VICE PRESIDENT, INTELLECTUAL PROPERTY, CISCO SYSTEMS INC.

Mr. LANG. Chairman Goodlatte, Ranking Member Watt, Members of the Subcommittee. Thank you for the opportunity to testify today.

I am Dan Lang, and I am Vice President of Intellectual Property, and Deputy General Counsel at Cisco Systems, where I am responsible for Cisco's patent strategy. I am here on behalf of not only Cisco, but also the Coalition for Patent Fairness, which includes the technology companies that employ hundreds of thousands of Americans, invest billions in U.S. research and development, and own tens of thousands of U.S. patents and patent applications.

I have come to testify today on an aspect of patent law that is very important to U.S. competitiveness and jobs—the prior user rights of inventors that develop technology that is then later patented by someone else.

As I will explain, I am going to ask you to consider small, but critical, changes to prior user rights law. Last year, Congress passed the America Invents Act, the AIA. It was the biggest change to our Nation's patent laws in the last 175 years.

One great indication of Congress' accomplishment in the AIA and the leadership of Chairman Smith, Chairman Goodlatte and Ranking Member Watt in bringing it to fruition, is that Mr. Armitage and I are here together singing from the same hymnal in supporting the same clarifications to the law.

One significant change in the AIA was a shift from a first to invent system, which awards a patent to the first to invent, to a first to file system which awards a patent to the first inventor to file. This is a positive step, which simplifies the patent system, and brings the U.S. into greater harmony with our peers.

But with a first to file system comes the possibility that an American company may develop technology and then be subject to claims of patent infringement by a patent holder, quite possibly a foreign competitor who filed for a patent on the same technology even if the American company invented it first, but had not yet patented it or otherwise publicized it.

A robust prior user rights system is therefore necessary to protect American businesses who invent first, but do not file patent applications and instead rely on trade secret protection. Many of us, particularly manufacturers both in traditional industries and new ones like Greentech, frequently rely on trade secret protection because we do not want to rely on patent enforcement in foreign countries to protect critical innovations, and we do not want to directly tip-off competitors as to technologies we are developing, which publication of patents would do.

But also we may not file for certain patents because there are numerous innovations in every product, and the money we spend on filing for patents on every conceivable invention is then not available to spend on research and development and hiring employees.

Because we should not and cannot file for a patent on every invention, we need prior user rights to protect us from the opportunistic players, including foreign ones, who will spend money to fig-

ure out which innovations we are already working on, and file patents to harass us.

We know that these concerns are not theoretical. A recent study showed that the prior user rights defense would have been raised in 90 patent infringement cases between January 1, 2005 and October 15, 2011. Virtually all of our foreign competitors enjoy prior user rights in their home jurisdictions.

The recent USPTO report on prior user rights very clearly explains the need for them, as did Chairman Smith in the discussions leading to the enactment of the AIA. I fully agree with Chairman Smith and the USPTO, and give credit to this Subcommittee for including broader prior user rights in the AIA.

Today, I am asking you to consider three technical changes to the prior user rights provisions of the AIA to ensure that they both provide the needed protections to American companies and to make them comparable to the provisions that our foreign competitors enjoy abroad.

First, I want to make it very clear that prior user rights protect all statutory subject matter, including both products and processes. The PTO report on prior user rights explains that commercial use of any subject matter can give rise to a prior user right. I agree with the PTO's understanding of the AIA here, and recommend that a modification be made to avoid any unintentional confusion that might make the prior user rights protection available to American companies narrower than that available to our foreign competitors.

Second, I am asking you to consider that the prior user rights language be modified to clarify the inclusion of substantial preparation of technology as a form of commercial use. This is especially important for those of us who spend years and millions of dollars to develop products for market. This protection is already available to our foreign competitors. Modified language would be very useful to clarify this important point.

Third, I am asking you to consider that the prior user rights language be modified to eliminate the requirement in the AIA that prior use take place at least a full year prior to the patent application's filing. This limitation puts my company and other American companies at a disadvantage compared to our foreign competitors that are not subject to it. The PTO report points out that this limitation is, "significantly more restrictive than that for any other prior user right system". Taking this restriction out will help put American businesses on par with foreign ones.

To conclude, these three suggested modifications would help assure an adequately robust system of prior user rights to protect American industry and jobs.

Thank you for inviting me to testify today. I have also provided a written statement that I ask be put into the record of today's hearing, and I will of course be happy to take any questions.

[The prepared statement of Mr. Lang follows:]

U.S. House of Representatives

Subcommittee on Intellectual Property, Competition, and the Internet

"Prior User Rights"

Written Statement of

Dan Lang
Vice President, Intellectual Property
Cisco Systems Inc.

On Behalf of

The Coalition For Patent Fairness

February 1, 2012

Written Comment of Cisco Systems, on Behalf of The Coalition for Patent Fairness

Chairmans Goodlatte and Smith, thank you for the opportunity to provide testimony on technical changes to the America Invents Act. The Act is the culmination of six years of effort[1] by Congress and the patent community to reform the patent laws. The Act fixes several long-term problems with our patent system. As the United States Patent and Trademark Office ("USPTO" or "Patent Office") recently recognized,[2] the Act must contain a robust prior user rights defense under 35 U.S.C. § 273, which goes hand-in-hand with the switch to a first-to-file system.

I. Introduction to Cisco and the Coalition for Patent Fairness

I am the Vice President for Intellectual Property of Cisco Systems. We are one of the world's largest manufacturers of telecommunications equipment that powers the Internet, with more than $40 billion in annual sales and more than 30,000 employees in the United States. Throughout our history as a company, Cisco's innovation has powered the development of data networking, including the emergence of the Internet as a global platform for collaboration and communication. Cisco invested $5.8 billion in the 2011 fiscal year on researching and developing the next generation of networking equipment. We hold over 8000 issued U.S. patents, testimony to both the extent of our innovative contributions and our commitment to the U.S. patent system.

I am here to represent not only Cisco, but also the Coalition for Patent Fairness ("CPF"). We are a cross-section of America's leading technology companies, consisting of top software, hardware, semiconductor, networking and Internet companies, including Autodesk, Dell, Google, Intel, Oracle, RIM, SAP, and Symantec. CPF's companies invest billions of dollars into research and development every year and have helped create the innovative culture that drives the U.S. economy. The coalition's companies help the United States to maintain its competitive edge into the future. Together we own tens of thousands of issued U.S. patents and applications. As major stakeholders in the patent system and the

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[1] *See, e.g.*, Patent Reform Act of 2009, H.R. 1260, 111th Cong.; Patent Reform Act of 2007, H.R. 1908, 110th Cong.; Patent Reform Act of 2005, H.R. 2795, 109th Cong.

[2] Report on the Prior User Rights Defense, United States Patent and Trademark Office, Jan. 2012 ("Report") (*available at* http://www.uspto.gov/aia_implementation/20120113-pur_report.pdf).

success of American innovation, we have worked together to seek improvements to the U.S. patent laws.

II. Prior User Rights Are Needed to Protect American Innovation and Jobs

One of the Act's most significant changes is that it shifts America's patent system from a first-to-invent system to a first-to-file system. This important harmonization with global patent standards ultimately can benefit the United States and US inventors, and that is why a broad cross-section of industry has long supported the principles behind such a change. Time-consuming challenges designed to prove "who invented first" are avoided by a first-to-file system. A pure first-to-file system gives all the rewards to the party that wins the race to the Patent Office, and denies any protection at all to the party that can show it first conceived the invention, but might have had legitimate business reasons not to seek patent protection. For this reason, the same broad industry support for first-to-file also includes support for prior user rights for those who invented first. While there are administrative benefits to a first-to-file system, there must exist a robust prior use defense for early innovators and prior users who do not obtain, or even file for, patent protection.[3]

Without a robust prior user rights defense, many American businesses would face disadvantages when competing against foreign entities. In order to obtain a United States patent, an inventor must publicly disclose its innovation. The resulting patent protection is limited to the United States, yet the public disclosure is available worldwide. Therefore, American businesses competing against foreign companies, or in markets outside the United States, may be better served by keeping some innovations private.[4] In addition, it is not always practical for an

[3] "Providing limited prior user rights in a first-inventor-to-file system addresses the inherent inequity such a system creates between an earlier commercial user of the subject matter and a later patentee." Report at 51.

[4] *See, e.g.*, Report at 3 ("Trade secret protection is of considerable value to United States businesses and the United States economy, and as such, there are compelling economic and policy justifications for providing a prior user rights defense to patent infringement."); Comments of James F. Kurkowski, Chief Intell. Prop. Counsel, Space Exploration Techs. Corp., to the USPTO, Comments of Space Exploration Techs. Corp. (Nov. 8, 2011) (describing the importance of trade secret protection in the space industry); Comments of Robert Barr et al., Executive Director, Bekeley Center for Law and Tech., Univ. of Cal., Boalt Hall Law School, to David Kappos et al., Undersecretary Dept. of Comm. for Intell. Prop. and Director of the USPTO, Prior User Rights for Venture Capital Backed Greentech Indus. (Nov. 6, 2011) (discussing the importance of trade secret protection in greentech to "American energy

American business to patent every invention it conceives, which may be in the thousands for a particular product. Without a robust prior user rights defense, American businesses who invent first, but do not file for reasons of trade secret protection or cost, would be subject to potential liability for patent infringement by those who later file for patents on the same innovations. We would be concerned by the prospect of opportunistic players, including foreign entities, investing engineering and legal resources in predicting the innovations that legitimate companies will soon bring to market and filing patent applications solely for the purpose of taxing the fruits of genuine product development. Without the need to develop products and services to satisfy real customers, they are free to invest all their resources to file numerous patent applications. Robust prior user rights maximize the protection to true innovators from such parasitic patent filing strategies.

Also, resources spent by U.S. companies to assure priority of patent application filings for every conceivable invention to defend against speculative litigation would significantly detract from being able to fund innovation through research and development and employment of a highly skilled workforce.

Indeed, we agree with the Chairman's earlier remarks that "[t]he inclusion of prior user rights is essential to ensure that those who have invented and used a technology but choose not to disclose that technology – generally to ensure that they not disclose their trade secrets to foreign competitors – are provided a defense against someone who later patents the technology." (Cong. Rec. Extension of Remarks, E1219, June 22, 2011).

The impact of the prior user defense on American industry is not just a theoretical one. A recent Lex Machina study determined that the prior user defense would have been featured in as many as 90 patent infringement cases in the United States between January 1, 2005, and October 15, 2011.[5] These cases would have involved defendants in a variety of industries and technologies, such as manufacturing, banking, communications, pharmaceuticals, biotechnology, computer hardware and software, transportation, and medical devices. As the study concludes: "The fact that the prior inventorship defense was relied on so

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independence, national security, manufacturing prowess, job generation capability, and general economic vitality.").

[5] Comments of Lex Machina, Inc., to the USPTO, U.S. Prior User Rights / Inventorship Study 2 (Nov. 7, 2011) ("Lex Machina Comments").

heavily (against expectation), and was successful so often, reflects the importance of prior user rights."[6]

III. American Businesses Need A Prior User Rights Defense That Puts Them On Equal Footing With Their Foreign Competitors

As the Chairman has previously stated, we must "ensure that our most innovative companies who hold many of the keys to U.S. economic competitiveness are provided sufficient prior user right protections to put them on an even competitive field *internationally*." (Cong. Rec. Extension of Remarks, E1219, June 22, 2011 (emphasis added)). The USPTO's recent prior user rights study echoed this sentiment when it concluded that "there is a strong preference that United States businesses be afforded the same advantages in terms of prior use protections in the United States that their competitors enjoy abroad."[7]

We agree with both the Chairman and the USPTO. Most foreign competitors recognize the advantages of, and enjoy the benefits of, a robust prior user rights defense in their local jurisdictions, including, for example, Austria, Denmark, Finland, Germany, the United Kingdom, Australia, Japan, and South Korea. Among European Patent Convention countries, only Cyprus does not have any prior user rights defense.

Importantly, the above countries have in common three basic protections for prior users.

First, foreign patent systems' prior user defenses protect *all* forms of invention, including processes, products, and products of processes, recognizing that the concerns about wasteful filings and the undermining of needed trade secret protection are generally applicable. Furthermore, protecting only processes is insufficient because patent claims can easily be written as apparatus and method claims. Indeed, the Lex Machina study revealed that the prior user rights defense in the identified 90 patent cases would have been applied against apparatus and method claims, suggesting that protecting only methods would leave legitimate prior users defenseless in many instances.[8]

Second, many foreign jurisdictions extend the prior user rights defense not only to products and processes already in commercial use, but also to protect

[6] *Id.* at 3.

[7] Report at 4.

[8] *See* Exhibit A to Lex Machina Comments.

substantial investments in the development or preparation of those products and processes.[9] For companies that develop and manufacture products, the research, development, and testing process can often take years and cost millions of dollars. In addition, many foreign jurisdictions do not limit prior user rights in time, instead protecting *any* activities that predate the filing of a patent application. A prior user rights defense that does not fully protect this investment has the perverse effect of penalizing American businesses who spend more time and investment in perfecting their products and services for the marketplace.

Third, prior user rights defenses in many foreign countries do not require the prior use to have occurred a full year before the relevant priority date. Generally, the defenses in foreign countries protect any private use that took place before the patent application was filed, and in some cases, any acts that took place before the patent was granted.[10]

IV. Proposed Technical Amendments

We must ensure that these three basic protections are equally available to American businesses under the AIA. Therefore, the Coalition for Patent Fairness proposes technical amendments be made to 35 U.S.C. § 273 that (1) clarify the

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[9] Report at 14-16.

[10] Examples from three of the U.S.'s most significant economic competitors, the United Kingdom, Germany, and Japan:

United Kingdom: Pursuant to Section 64 of the Patents Act of 1977, a person is not liable for patent infringement if, before the patent is granted, that person either "does in good faith [the patented] act" or "makes in good faith effective and serious preparations to do [the patented] act." UK Patents Act, § 64(1). This defense protects products as well as patented acts. *Id.* at § 64(3). Moreover, if the act or preparation was done "in the course of a business," the prior user right is transferrable along with the business. *Id.* at § 64(2).

Germany: German law similarly protects both actions and preparations, and allows for transference of prior user rights along with a business. Section 12 of the German Patent Act states, in part: "A patent shall not apply to a person who had already been using the invention in Germany, or had made the arrangements necessary for doing so at the time of the filing of the application. . . . This authorization can only be willed or transferred together with the business."

Japan: Rather than framing it as a defense, Japanese law grants prior users a non-exclusive license to patented technology and extends that protection to preparation as well. Japanese Patent Act, Article 79 states, in part: "A person who . . . made an invention identical to the said invention, or a person who . . . has been working the invention or preparing for the working of the invention in Japan at the time of the filing of the patent application, shall have a non-exclusive license on the patent right, only to the extent of the invention and the purpose of such business worked or prepared."

intended scope of the prior user rights defense and (2) align the defense with the protections that foreign competitors enjoy abroad.

First, the proposed amendments must make clear that all statutory subject matter – and not just processes – are protected under the prior user rights defense. Importantly, and as noted above, foreign patent systems' prior user defenses protect *all* forms of invention. Moreover, the Report states: "[T]he same 'commercial use' standard is applied to all statutory subject matter, specifically defined in the AIA as, 'subject matter consisting of a process, or consisting of a machine, manufacture, or composition of matter.'"[11] We appreciate the USPTO's understanding of the AIA's intent to capture products as well as processes in the prior use defense, and recommend amendments be made to avoid any unintentional confusion with the current statutory language.

Second, the proposed amendments must expressly include substantial preparation of technology among the protected subject matter, and not only products and processes already in commercial use. Again as noted above, this is an important protection afforded to foreign competitors. This is of particular importance in those fields where companies must spend years (and millions of dollars) developing products for market. Protecting these investments is an important part of the America Invents Act. Amendments would be useful to simply clarify this point.

Finally, the proposed amendments must eliminate the requirement that prior use take place at least a full year prior to the patent application's filing. Such a limitation does little more than put American companies at a disadvantage to foreign companies that are not encumbered by any such limitation. As the Report notes, the present statute is "significantly more restrictive than that for any other prior user rights system."[12] Removing this artificial date restriction will put American businesses on par with foreign entities.

V. Conclusion

Without a robust prior user rights defense, the patent system will strip technology and jobs away from Americans, punish independent inventors for filing second and put American companies at a disadvantage over foreign competition. With them, American businesses can compete on equal footing and put their technologies to work at home. The proposed amendments ensure that American businesses can do just that.

[11] Report at 7.

[12] *Id.* at 21.

Mr. GOODLATTE. Thank you, Mr. Lang. Dr. Vaughn, welcome.

TESTIMONY OF JOHN C. VAUGHN, EXECUTIVE VICE PRESIDENT, ASSOCIATION OF AMERICAN UNIVERSITIES

Mr. VAUGHN. Thank you, Chairman Goodlatte, Ranking Member Watt and Members of the Subcommittee. I appreciate this opportunity to present the views of the higher education community on

prior user rights and their impact on U.S. manufacturing and innovation.

The proposed expansion of prior user rights defense was one of the most contentious issues debated over the course of the more than 6-year effort at patent reform of U.S. patent law.

The higher education community was strongly opposed to that proposal. Private sector groups argued just as strongly for the need for an expanded prior user defense. To explain the concerns of the higher education community about prior user rights, I would like to make a few brief comments about the nature of university research.

Universities are the major performer of the Nation's basic research—56 percent of it in 2008. The 1980 Bayh-Dole Act, which allowed universities and small businesses to retain patent and licensing rights to the results of federally funded research, greatly enhanced the ability of universities to contribute to the Nation's innovative capacity and economic competitiveness by transferring their discoveries into the commercial sector for development.

A couple of anchor points illustrated by those impacts—in 1985, 500 patents were granted to the top 200 research institutions. In 2009, university research led to the issuance of 3,147 patents, 596 new companies and 658 new commercial products. Given the productivity and promise of university research, both the Federal Government and universities are now focusing on ways to increase the breadth and pace of university research commercialization.

One of the key obstacles to increasing commercialization is the so-called "Valley of Death"—the gap between early-stage university inventions and their successful commercial development into products and processes that benefit the Nation.

This has led to a growing recognition of the importance of proof of concept programs that support the next stage of concept development, market analysis and attendant activities often needed to move promising but early-stage university inventions into the commercial market.

The important point here is that the early-stage, high-risk nature of university inventions that calls for developing proof of concept programs to expand and accelerate commercialization is the same aspect of university inventions that calls for avoiding overly expansive prior user rights policies that could move commercialization in the opposite direction by increasing uncertainty and weakening patents, crippling the ability of universities to license those patents for development.

We believe that the AIA prior user rights provisions have struck an effective balance between the needs and interests of the private sector for an expanded prior use defense, and the necessity for universities to preserve an environment in which they can license their inventions effectively into the commercial sector.

The key provisions of the AIA prior user rights scheme for universities are the following: most important is the exemption of university patents from the assertion of a prior user rights defense. This provision will free early-stage, high-risk university patents from the added risk of prior user immunity from patent rights, which would create a disincentive for companies to license university patents.

The 1-year separation of commercial use from a later patent filing or disclosure qualifying for the grace period reduces the risk particularly that university licensees, most of which are start-up companies and small businesses, will be developing new technologies in a market that includes substantial trade secret products or processes immune from the patent rights of that company. Reducing that risk encourages investment in such new technologies at a sensitive, early stage.

The USPTO's thorough, thoughtful report on prior user rights defense recommends that the AIA prior user rights defense should be maintained with no change at the present time, but that USPTO should reevaluate the economic impacts of prior user rights as part of its 2015 report to Congress. We agree with those recommendations.

Thank you.

[The prepared statement of Mr. Vaughn follows:]

STATEMENT OF

JOHN C. VAUGHN
EXECUTIVE VICE PRESIDENT
ASSOCIATION OF AMERICAN UNIVERSITIES

ON BEHALF OF

ASSOCIATION OF AMERICAN UNIVERSITIES
ASSOCIATION OF PUBLIC AND LAND-GRANT UNIVERSITIES
AMERICAN COUNCIL ON EDUCATION
ASSOCIATION OF AMERICAN MEDICAL COLLEGES
ASSOCIATION OF UNIVERSITY TECHNOLOGY MANAGERS
COUNCIL ON GOVERNMENTAL AFFAIRS

BEFORE THE HOUSE JUDICIARY SUBCOMMITTEE ON INTELLECTUAL PROPERTY, COMPETITION AND THE INTERNET

"PRIOR USER RIGHTS: STRENGTHENING U.S. MANUFACTURING AND INNOVATION"

FEBRUARY 1, 2012
10:00 A.M.
2141 RAYBURN HOUSE OFFICE BUILDING

One of the most contentious issues debated over the course of the effort to reform U.S. patent law was whether to expand the existing prior user rights provisions, which were available as a defense against infringement of business method patents only. The higher education community was strongly opposed to the proposed expansion of prior user rights to be available as a defense against infringement of all patents, while private sector groups argued for the need for a broad prior use defense, particularly if the U.S. were to move from a first-to-invent to a first-inventor-to-file system for determining patent priority. The America Invents Act (AIA) includes a carefully crafted set of prior user rights provisions that addresses the concerns raised by the higher education community while responding to the legitimate interests of private sector companies.

University Research

To understand the concerns of the higher education community about a broad expansion of a prior use defense and how the AIA effectively addresses those concerns, it is useful to review the nature and history of the research conducted by U.S. universities.

Universities perform the largest portion of the nation's basic research. In 2008, universities performed 56% of basic research, more than the private sector, federal government, and other nonprofit organizations combined. Universities also performed about 12% of the nation's applied research, slightly less that the federal government.

University research has greatly strengthened the nation's innovative capacity and economic competitiveness. More than half of U.S. economic growth since World War II has resulted directly from technological innovation, much of which stems from scientific, medical, and engineering research at our universities.

The capacity of the nation's research universities to contribute to innovation and economic competitiveness was greatly enhanced by the passage of the Bayh-Dole Act in 1980. Prior to 1980, the federal government retained patent and licensing rights to the results of federally funded research. On the face of it, that made good sense: taxpayers had paid for the research, and the federal government therefore ought to retain title to inventions resulting from that research. But the consequence of that policy was that most inventions remained on the shelf, undeveloped. Senators Bayh and Dole introduced legislation that allowed universities and small businesses to retain the rights to inventions resulting from federally funded research. The result of enactment of that legislation was a dramatic increase in university – industry technology transfer:

- In 1985, shortly after the legislation was passed, 500 patents were issued to the top 200 research institutions,
- In 2009, university research led to the issuance of 3,417 patents, 596 new companies, and 658 new commercial products.[1]

[1] http://www.autm.net/AM/Template.cfm?Section=Documents&Template=/CM/ContentDisplay.cfm&ContentID=5237

- A 2009 study by the Biotechnology Industry Organization estimated that university-based inventions contributed $450 billion to the U.S. gross industrial output and created 280,000 new high-tech jobs between 1999 and 2007.[2]

Federally funded university research has played a critical role in the development of the laser and its myriad applications, microprocessors, magnetic resonance imaging and later MRI applications, the CAT scan and PET/CT scanner, synthetic Taxol, and the Global Positioning System to name just a few.

University research has produced not only ground-breaking inventions that have led to valuable products, processes, medicines, medical treatments, and new technologies in a wide range of fields, but also have led to the creation new companies — as noted above, 596 new companies in 2009. The Science Coalition has produced a list of 100 companies that have grown out of federally funded university research.[3] These include major companies such as Google, Cisco Systems, Genentech, Sun Microsystems, and Xenogen, a leader in "in vivo" optical imaging.

Given the productivity and promise of university research, both the federal government and universities have given increased attention to ways to increase the breadth and pace of commercialization of university research. The Bayh-Dole Act and subsequent development of highly professional university technology transfer offices have greatly expanded university technology transfer, but it is clear that more can and should be done. One of the key obstacles to increasing the breadth and pace of the commercialization of university research is the so-called "valley of death," the gap between early-stage university technologies and the development of commercial products and processes that benefit the nation. Universities and their researchers do not have the resources to support the proof-of-concept work, market analysis, and mentoring often needed to move very early-stage discoveries effectively into the commercial market.

The importance of proof of concept programs has been recognized by the European Research Council (ERC), which has announced a new proof of concept funding initiative to help bridge the gap between ERC-funded research and the earliest stage of marketable innovations.[4] The Wallace H. Coulter Foundation has established a proof of concept grant program in biomedical engineering for both individual researchers and institutions.[5] Coulter program projects have generated a 5-1 overall return on investment (ROI) in new follow-on funding, and a 42-1 ROI for the top 10 percent of portfolio projects. The reauthorization of the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs includes authorization of $5 million for the National Institutes of Health to implement a proof of concept program.

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[2] http://www.oregonbio.org/Portals/0/docs/Education/BIO_EDU_partnership_final_report.pdf
[3] http://www.sciencecoalition.org/successstories/
[4] http://news.sciencemag.org/scienceinsider/2011/03/europe-nudges-top-scientists-to.html
[5] www.whcf.org/partnership-award/overview

The commercial potential of university research is evident from the translation of fundamental discoveries into products, processes, and companies that enhance the nation's innovative capacity and strengthen its economic competitiveness. However, the early-stage, high-risk characteristics of discoveries resulting from university basic research create special challenges for translating those discoveries into successful commercial development. The growing recognition of importance of proof of concept programs is one adaptive response to these challenges.

The same early-stage, high-risk characteristics of university discoveries that call for proof of concept programs also call for protection against the increased difficulty of licensing those discoveries that could be brought about by a broad expansion of a prior use defense.

University Research and Prior User Rights

Historically, universities have opposed the inclusion of a broad prior use defense in U.S. patent law on the basis of both principle and impact. As a matter of principle, a broad exclusion from the assertion of patent rights could vitiate the fundamental purpose of patent policy to encourage innovation by granting exclusivity for the commercial use of a patented invention in return for providing the public a full and enabling disclosure of that invention. In terms of impact, an expansive prior use defense could seriously impair the ability of universities to license their patents into the private sector for development. The early-stage, high-risk characteristics of university patents creates challenges in licensing. The prospect of an expansive and expanding pool of trade-secret products immune from the assertion of patent rights could weaken university patents and discourage private sector companies from licensing those patents.

However, over the course of the more than six-year effort to reform U.S. patent law, the university community came to recognize the importance to some private sector companies of the availability of a prior use defense to patent infringement extending beyond the limitation to business method patents. In complex products and manufacturing processes, many containing hundreds or even thousands of patented components, it may not make sense to patent every component or process. But such unpatented products or processes, often developed under trade-secret procedures, could become vulnerable to a charge of infringement from a later-granted patent on the same subject matter, threatening an entire product or process based on an unpatented component. An appropriately structured prior user rights scheme could provide legitimate protection against such a prospect.

The America Invents Act (AIA) effectively balances the concerns and interests of universities and private sector companies with respect to the availability of a prior use defense to patent infringement. The Act addresses these concerns and interests while constraining the development of a massive pool of trade secret products immune from the assertion of patent rights, as well as the prospect that such products could be derived from early disclosures of discoveries for which patent protection will later be sought.

From a university perspective, the most critical provisions of the AIA prior user rights scheme are the following:

- All university patents are exempt from the assertion of a prior use defense, save those resulting from research that could not have been conducted with federal funds.

- Because the exemption inheres in the patent, the protection against the assertion of a prior use defense extends to university licensees, thus mitigating the potential disincentive to license university patents.

- The product or process to which prior user rights may be applied must have been in commercial use at least one year before the effective filing date of a patent against which a prior use defense could be asserted; this one-year separation of commercial use from patent filing offers protection against the prospect of trade secret products being derived from disclosures and then utilized as a prior use defense.

- A product or process eligible for prior user rights must also have been in commercial use at least one year in advance of a disclosure qualifying for the one-year grace period; this provision protects early disclosure and supports the university mission to disseminate the results of research quickly and broadly.

- The one-year separation of commercial use from a patent filing or disclosure qualifying for the grace period is important for university licenses, most of which are start-up companies or small businesses. These companies need to create new technology improvements to the basic university discovery in developing useful commercial products. The one-year separation of commercial use from later patent filings and disclosures reduces the risk that a start-up or small business will be patenting new technologies for a market that includes substantial trade secret products or processes immune from the patent rights of that company. Reducing that risk encourages investment in such new technology at a sensitive early stage.

Conclusion

All countries now operate under a first-to-file system for determining patent priority, and most of these countries have some form of a prior use defense. For many in the university community, prior user rights remains a concept uncomfortably arrayed against the Constitutional and public purposes of U.S. patent law, yet there is evidence that it can promote fairness in protecting a prior commercial user against unintended infringement of a later-granted patent, reduce the pressure for defensive patenting, and provide U.S. businesses with prior use protections available to their foreign competitors in other countries.

The thorough, thoughtful "Report on the Prior User Rights Defense" produced by the USPTO concludes in part: "The recently enacted AIA incorporates a carefully crafted prior use defense consistent with the prior use defense found in many industrialized countries, with certain unique features so that [only the] parties who can prove commercial use at least one year prior to the filing date of the patent application can obtain the defense. The scope of the defense is limited in the type of activities that may be continued in relation to the original prior use activities so that the patentee's rights are not unjustly impinged."

The report recommends that the AIA prior user rights defense should maintained with no changes at the present time, but that USPTO should reevaluate the economic impacts of prior user rights as part of its 2015 report to Congress on the implementation of the AIA. We agree with these recommendations.

Mr. GOODLATTE. Thank you, Mr. Vaughn. Professor Crouch, welcome.

TESTIMONY OF DENNIS CROUCH, ASSOCIATE PROFESSOR OF LAW, UNIVERSITY OF MISSOURI SCHOOL OF LAW

Mr. CROUCH. Thank you, Chairman Goodlatte and Ranking Member Watt. Thank you for inviting me here today to testify.

I was here last year in the ramp up to the passage of the AIA, and we have moved a great distance. I also want to take just a moment to thank your Committee for all of your hard work on intellectual property in general, and for both preserving the rights of innovators as well as the rights of users.

At the same time, I think we should congratulate Director Kappos and his entire staff for all of their efforts in putting the AIA into place. I receive about two dozen emails each day from patent attorneys around the country, and I continue to be surprised and amazed at the good feeling that continues to be exhibited toward Director Kappos because of his responsiveness to the patent community.

Now the biggest change that has occurred at the Patent Office in the past 6 months since the passage of AIA is that the Patent Office now has more funding. And what they are doing with that funding is addressing the tremendous backlog of cases that continue to be pending at the Patent Office. And I know this is the field of this hearing, but I just hope that you will continue that funding as we move forward.

Now, I want to speak for a moment about prior user rights as what we might call a protectionist measure. On balance, prior user rights—what they do is take rights away from the patent holder, and give them to manufacturers and commercializers, right? And our rights go to U.S. manufacturers and U.S. commercializers.

Because of the U.S. territorial limitation, the folks that receive rights are typically in the U.S. while the patentees losing rights could come from any country around the world.

Now, important in this analysis, and I think important in the politics of why this was passed is the realization that now for the first time in history, more U.S. patents are being applied for by foreign entities than by American entities. And this changes the calculus, and I believe this signals what is a growing shift in our perspective on the balance between rights of users and rights of innovators.

Now, Dr. Vaughn has spoken about a major caveat here of universities, and universities sit in a unique position in our system because they are typically not manufacturers, right? And so, they are just patent holders in this system, and so this—all right, so the law was created, and from this front I agree with both Mr. Vaughn and Director Kappos that without the particular exception for universities the law that was passed would uniformly hurt universities more than most other U.S. entities.

Now the main point of my testimony that is—the main point of my written testimony parallels much of Mr. Armitage's statements. And that is that prior user rights as drafted in the AIA are in reality unlikely to have any substantial impact on innovation.

And the way we know this comes directly from the USPTO report where the USPTO looked through the decades of the European experience and found no impact. They looked through the first half of the century in our system, and found no impact. They looked through the past decade where we had prior user rights for business method patents, and found no impact. Right?

And this leaves me to a nice conclusion that prior user rights, as we have them now, right, are not creating a problem. They are unlikely to shift our innovative environment, right, and as Director Kappos mentioned and Mr. Armitage mentioned, prior user rights have the benefit of, in those rare cases where they come into play, having an important equitable result that we see is fair. I think I will conclude my remarks.

Thank you.

[The prepared statement of Mr. Crouch follows:]

Committee on the Judiciary
United States House of Representatives
Subcommittee on Intellectual Property, Competition and the Internet
Hearing

"Prior User Rights Defense"

Prepared Statement of
Dennis Crouch*
February 1, 2012
Washington, DC

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* Associate Professor of Law, University of Missouri School of Law; J.D., University of Chicago School of Law (honors); B.S.E., Princeton University (Department of Mechanical and Aerospace Engineering) (honors).

My academic research interests focus on patent law, intellectual property law and internet law. I also teach courses on property and civil procedure and am a member of the University of Missouri's Center for the Study of Dispute Resolution and the International Institute for Conflict Prevention & Resolution (CPR) Patent Mediation Task Force. In addition to traditional academic publications, I coauthor the *Patently-O Patent Law Blog* that has a daily circulation of over 30,000 and is regularly read by most US patent law practitioners. Prior to joining the University of Missouri faculty, I was a visiting professor at Boston University School of Law and worked as a patent attorney at a major intellectual property law firm in Chicago where I represented inventors pursuing patent protection as well as clients litigating claims of patent infringement. Before entering law school, I served with my wife as a United States Peace Corps Volunteer in rural Ghana, West Africa; worked as a manufacturing engineer in upstate New York; and conducted research on microgravity combustion with NASA in Cleveland. I am not a registered lobbyist, I do not represent any clients, and I do not own stock in any particular company with a vested interest in patent rights (beyond broad-based mutual funds).

Thank you for this opportunity to present my remarks and testimony regarding prior user rights and their potential impact under the Leahy-Smith America Invents Act that was recently enacted into law. Before moving forward, I first would like to commend this Subcommittee and the Congress as a whole for its ongoing focus on intellectual property rights and in taking steps to ensure that we have an intellectual property system that makes sense in society, today and tomorrow. I also want to take a moment to congratulate Undersecretary of Commerce David Kappos and his entire team at the United States Patent & Trademark Office for their continued efforts in managing the administration of US patent rights and in implementing the myriad provisions of the America Invents Act. Director Kappos and his staff continue to be highly responsive to the needs of patent applicants and continue to receive high marks from the patent law community. The most notable change in the past six months is that the USPTO now has increased funding and is using that funding to address the bottlenecks that have led to such a large backlog of pending patent applications. I hope that you will continue to fully fund the USPTO while maintaining the proper level of oversight.[1]

I make only a few main points in this testimony. The biggest point is my assessment that prior user rights as formulated in the America Invents Act will have only an insignificant and likely immeasurably small impact on our patent system. For that reason, I cannot call it a robust system of prior user rights. In section III, I introduce a set of potential changes that would lead us to a more robust regime. Section IV considers how prior user rights may have a differential impact on US entities as compared with foreign holders of US patent rights. That discussion is highly relevant in light of the fact that most new US patent applications are filed by foreign entities. Although the USPTO has done an admirable job with its report, I present two major criticisms in Part V. Finally, in part VI, I address some ambiguities of the prior user statute that could be fixed by technical amendment.

I. Introduction to Intellectual Property and Prior User Rights

Balancing Intellectual Property and Market Competition: My own entrée into intellectual property begins with the concept and principle that a market economy demands free and fair competition. Patent and copyright laws are exceptions to this principle. With intellectual property rights, we partially subordinate our freedom to compete in order to provide incentives

[1] Although outside of the scope of today's hearing, three particular points of oversight that the subcommittee may want to address include: (1) The USPTO may need oversight in addressing its enormous and growing backlog of appeals pending before the Board of Patent Appeals. The number of pending appeals before the Board is now over 25,000. That figure has risen every month without fail for the past seven years. (2) The USPTO may need oversight in developing its fee structure for the new post-grant opposition proceedings. In my view, the fees for such a proceeding should be set at a low enough level to encourage third parties to challenge improperly issued patents well before litigation occurs. (3) Finally, as part of the AIA, the USPTO is in the process of implementing a system that allows third-parties to submit prior art and comments to the PTO regarding patent applications under examination. Oversight may be necessary to ensure that the USPTO implements this system in a way that invites participation and collaboration in the system.

for innovators to create and develop new ideas and new products. I strongly support intellectual property rights and firmly believe that the prospect of rights provides a strong incentive to innovate and also a market mechanism for exchange. However, in managing our intellectual property system, we must remain diligent to guarantee that these rights do not inadvertently hamper our competitive drive – especially for small businesses and potential entrepreneurs. In this context, an ideal intellectual property system should promote both innovation and competition.

Federalism, Prior User Rights, and the Need for Simplicity: Today's discussion is focused on prior user rights. That topic also calls to mind a separate but equally longstanding principle – that of federalism and individual state control over the management and allocation of property rights. Although the Federal Government has taken preemptive control over patent law, individual states continue to maintain systems that protect companies against trade secret violations and unfair competition as well as enforce contractual employee invention agreements and non-compete contracts. As a professor, I know that even my law students have some difficulty fully comprehending this federal system. For entrepreneurs, these rights form an overlapping morass. This is especially true for start-up companies who may have an excellent product and marketing strategy but who will likely lack a director of regulatory affairs – or even a general counsel. It is undoubtedly true that the complexity of regulation, enforcement, and potential liability all tend to chill innovative activity. In this context, an ideal intellectual property system should be as simple and straightforward as possible. Otherwise, the system will merely be the plaything of established entities protecting their market share and lawyer-driven entities gaming the system.

The Oddity of Prior User Rights – Granting Patents for Old Inventions: Under US law, a patent must be directed to a "new" invention.[2] However, it has always been the case that patents are occasionally rightfully granted even though the claimed invention is not *strictly* new. This disjunction traditionally stemmed from a requirement that a challenger present corroborated evidence of prior invention as well as the notion that a prior inventor who had abandoned his invention deserved no patent rights.[3] With the implementation of a first-to-invent system, there will be more potential opportunities for patents to be lawfully granted even when the claimed inventor was not the first inventor. Prior user rights are then intended to cure the potential inequity that could otherwise occur when the patentee sues a prior inventor for infringement.

[2] 35 U.S.C. § 101. The "new" language from this statute is derived from the original patent act enacted in 1790.

[3] See 35 U.S.C. §102(g) (pre-AIA).

II. The Likely Insignificant Impact of Prior User Rights

Although veiled in its statements, the USPTO Report on Prior User Report latches-on to the common sentiment in the patent law community that the prior user rights of the America Invents Act are so narrowly circumscribed that they are unlikely to have any measurable impact on the market for patents or demand for innovation. In my estimation, we will see very few cases emerge where prior user rights make a difference for an accused infringer.

Let me explain:

There are host of conditions that must be met before the prior user defense can be exerted. Most notably, an accused infringer must be able to show that it (or its predecessor in title based upon limited transfer rights) began to commercially use the invention at least one year before the patentee's filing date (and even further in advance if the patentee publicly disclosed the invention before filing). In the new statute, the defense only applies if prior user's version of the invention was created independently and without derivation from the patentee's version and the prior user acted in good faith. When formed together, these requirements look something like the eye of the needle and are difficult to pass through.

Further marginalizing the impact of prior user rights is the reality that the defense is only adds actual value when the patent being asserted is valid. *I.e.*, if the patent is invalid then there is no need for a prior user defense. The setup of a prior user situation suggests two likely scenarios that would lead to a decision of unpatentability. First, the existence of multiple independent creators of the same invention tends to suggest that the invention itself was obvious and therefore unpatentable.[4] Using the language of the Supreme Court in its KSR decision: "market forces" likely prompted researchers to take the next step.[5] In addition, the requirement that the prior user commercially used the invention is an indicator, albeit inconclusive, that anticipating prior art may be available to invalidate the patent. Conversely, if the prior user is successful in maintaining the secrecy of its commercial use for that time period, we're left with the suggestion that the prior user may able to continue to operate in secrecy without being uncovered and thus without being charged with infringement.

My conclusion that prior user rights will have very little impact on innovation and access is also supported by comparative analysis of the impact of prior user rights in various trading partner nations and the already existing US prior user right for business method patents. The USPTO report correctly indicates that these defenses have seen little to no successful assertion. In the US, prior user rights have been available since 1999 for the limited class of business method patents. During that time, there have been no reported cases where the defense was successfully asserted. During this time, the Court of Appeals for the Federal Circuit decided

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[4] See Robert P. Merges, *Commercial Success and Patent Standards: Economic Perspectives on Innovation*, 76 Cal. L. Rev. 803 (1988); John F. Duffy, *A Timing Approach to Patentability*, 12 Lewis & Clark L. Rev. 343 (2008).

[5] *KSR Int'l Co. v. Teleflex, Inc.*, 550 U.S. 398 (2007).

thousands of patent appeals on almost every imaginable patent doctrine – however the court did not address prior user rights. There was no need because the impact of that defense is so limited.

Two final concepts – lack of assurances and delay in patenting – push me to the same conclusion of little impact. First, I suggest that prior user rights will be given little *ex ante* consideration by would-be defendants because the right does not offer any real assurances or any vested right until years after the first commercial use. As discussed in the previous paragraphs, prior user rights only come into play under a cone of secrecy. At that time, the prior user has no assurances that it made commercial use of the invention more than a year before someone else filed a patent application on the same subject matter. The expense of searching PTO records makes the task of discovering prior patent applications quite difficult. The delay in publication of applications and later-filing of applications based on foreign priority makes this task literally impossible to complete. And, the ability of patent applicants to radically amend claims during the patent prosecution process means that any assurances identified cannot not be considered vested.

The final point – based on delay in patenting – is that most qualifying prior uses may be irrelevant and out-of-use by the time that the USPTO issues the covering patent. Most recently issued US patents have an effective original filing date of more than four years ago. This provides a window of at least five years for most prior users to legally practice the invention without recourse even in the absence of the prior user defense.[6] In many areas of technology, the original prior use will have become obsolete by the end of that five-year timeline – allowing the prior user to move to a new technology without ever needing to obtain a license or permission from the patent holder.

III. Developing a Robust Regime of Prior user Rights

As I discuss above, the prior user rights regime of the AIA is not robust in any practical sense of the word. A robust regime would include prior invention, non-commercial use (such as laboratory research), and reduction to practice as triggers for establishing the right. A robust regime would create the opportunity for the establishment of a vested prior user right – perhaps through a registration system. A more robust regime would also eliminate the one-year pre-filing deadline. An even more robust regime would focus on the timing of patent claims. If new patent claims are added during the prosecution process, others may have rights if they were users before that date. A more robust system would follow this same approach for patent claims amended or added in the new array of post grant proceedings.

[6] Under certain circumstances, a patentee may sue an infringer for back-damages that occurred prior to patent issuance under 35 U.S.C. §154(d). However, that cause of action is quite limited and very few patentees have been successful.

Here, I am not prepared to recommend that these policies be implemented. What I can say, however, is that the current system does not robustly protect prior users.

IV. Relative Benefit of Prior User Rights for US Manufacturers and Universities

On their face, US patent rights do not provide preferential treatment to US innovators or business owners as compared with foreign nationals. In fact, US treaty obligations under the Paris Convention for the Protection of Industrial Property (Paris Convention) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) require that the US offer national treatment to citizens of all our treaty partners. This national neutrality is respected at the USPTO and I have seen no perception of discrimination based upon national origin of inventors or patent owners. The national neutrality is also reflected in the reality that most corporate entities filing for patent protection in the US are foreign corporations and not US corporations.[7]

Unlike the much of the rest of the patent law statute, however, prior user rights do include a US-focused location limitation for establishing a right to assert the defense. In particular the defense is only available if the prior use was commercial use in the US. This limitation on the geographic site of US prior user rights has the potential of differentially impacting US industry, and it makes sense to consider whether US entities may be preferentially treated. The following table highlights the potential relative impact of prior user rights on various stakeholders.

Stakeholder	Helped or Hurt by US Prior User Rights
US Universities	**Helped**: University derived inventions become relatively more valuable because they are normally not subject to prior user rights.
US Manufacturers and Technology Companies	**Helped and Hurt**: US patents belonging to US manufacturers become less valuable because they are subject to prior user rights. However, US manufacturers have the potential of avoiding infringement charges based upon their own prior use.
US Non Practicing Entities (NPEs)	**Hurt**: NPEs US patents become less valuable for NPEs because they are subject to prior user rights. By definition, NPEs do not practice the invention and therefore do not benefit from the prior user right defense.
Foreign Manufacturers and Technology Companies	**Hurt**: Foreign entities US patents become less valuable because they are subject to prior user rights. Further, the foreign entities cannot assert prior user rights based upon activities in their home countries. However, foreign entities could benefit from the prior user rights if their prior commercial use of an invention was in the US.

[7] See U.S. Patent Statistics Chart for Calendar Years 1963 – 2011, available at http://www.uspto.gov/web/offices/ac/ido/oeip/taf/us_stat.htm.

The relative impact here is to primarily benefit US stakeholders – especially US universities and manufacturers. Because the benefits are triggered by commercial use in the US, the law should encourage entities to take those actions in the US rather than abroad.

Congress should always be cautious in developing intellectual property laws that preferentially treat US-based entities both because of treaty obligations and because of the potential for creating international turmoil. In this case, however, the vast majority of the US's major trading partners have already implemented prior user rights that, in parallel fashion, marginally benefit their home industries. Thus, in this case, the US is merely catching-up to our trading partners' protectionist practices.

V. Criticisms of the USPTO Report on Prior User Rights

The USPTO's extensive report is admirable in the face of a dearth of evidence available on prior user rights. I have two primary criticisms of the USPTO report.

First, the USPTO arrived at a conclusion that the prior user rights created in the America Invents Act "strikes the right balance." Their conclusion was derived from the fact that we have no evidence to the contrary. Of course, that conclusion does not hold under any logic. No one in business, academia, or government has explored the prior user issues in sufficient depth to answer the questions posed by Congress. If we want answers, then the USPTO should roll up its sleeves and conduct a study that gets to the answers. Of course, that approach takes time and money.

My second criticism is about whether the USPTO is the proper body to be answering this particular question. The problem is that under US law, the USPTO has no role in patent infringement analysis, patent litigation, or regulation of start-up ventures. The agency has no expertise in this area and yet is being asked to determine the general impact of the law. A superior body may be the FTC, the Courts, and the community of US innovators.

VI. Ambiguities

The most difficult portion of the prior user rights provision is Section 273(e)(5)(B), which is an exception to the general university exception of 273(e)(5)(A). It reads as follows:

> (B) EXCEPTION—Subparagraph (A) shall not apply if any of the activities required to reduce to practice the subject matter of the claimed invention could not have been undertaken using funds provided by the Federal Government.

It is my view that this subsection needs to be entirely rewritten to more clearly identify the rule of law.

Finally, because these rights will be adjudged in the course of federal court litigation, the impact of the defense may be substantially impacted by the court's choices regarding burdens

of proof, corroboration of testimony regarding prior use and sufficiency of the evidence, waiver, etc. The current law provides no guidance on those issues that may be the key deciding factors in many cases.

VII. Conclusion

Thank you for this opportunity to present my remarks.

Mr. GOODLATTE. Thank you very much, and we will now move to our questions for the panel.

The gentleman from North Carolina, Ranking Member Mr. Watt, is recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

And I thank the witnesses again for being here.

Let me see if I can clarify one thing between Mr. Lang and Mr. Vaughn to see whether there is a difference or not. Mr. Lang seems to suggest that we need to do three technical modifications. I am not sure that they are necessarily technical modifications.

One is clarifying that all innovations are covered under prior user rights. I think that already exists. Do you agree that that already exists, Dr. Vaughn?

Mr. VAUGHN. Mr. Lang said that the language was somewhat confusing, and that is probably why I wouldn't give a crisp answer. I think it was intended to circumscribe subject matter so that prior user rights would not cover all subject matter, but focus on processes or products used in processes. I believe that——

Mr. WATT. Do you agree that needs to be clarified, or do you think we ought to leave it?

Mr. VAUGHN. Universities would be comfortable with a narrower definition, but I think this is something really that ought to be discussed further.

Mr. WATT. But I think Mr. Lang is talking about a broader definition. Am I misinterpreting what you are saying, Mr. Lang?

Mr. LANG. No, I don't believe so, Ranking Member Watt. In fact, what we are seeking is a clarification that the language does not indeed include all subject matter.

Mr. WATT. It includes all subject matter, and the universities would have some concerns with that?

Mr. VAUGHN. Our preference would be to have the focus on process. This was one of the issues debated a great deal in the compromise, and, I must confess, I think where we came out is in a somewhat murky area, and clarifying that would be worthwhile.

Mr. WATT. It would create war again, huh?

Mr. VAUGHN. No, no. no. I don't think so. [Laughter.]

Mr. WATT. Substantial preparation, which is not obviously included under the current prior user language in the AIA, and the 1-year requirement, which is included, which Mr. Lang wants shortened, I assume you would have some concerns about that?

Mr. VAUGHN. I think that is an area where we would have concern. The substantial preparation strikes us as a much more open-ended standard. As Director Kappos said earlier this morning, you likely would need litigation to try to clarify that, and one of the major thrusts of AIA was to try to reduce litigation.

So that, I think, would give us some concern, and we—having the 1-year look back was a very important part of the compromise for us.

Mr. WATT. Okay, then there is at least substantively some disagreement on these two points between Mr. Lang and Mr. Vaughn. Let me see if I might be able to narrow the differences.

Mr. Lang, how soon do you think we should attempt to make the suggested technical changes that you have suggested? Maybe that would give us more comfort here.

Mr. LANG. My recommendation is that these changes be made as soon as possible.

Mr. WATT. Which is before 2015? Or should we await the report in 2015? Do you think we are doing ourselves a substantial injustice by waiting until 2015 to reopen this again?

Mr. LANG. Yes. I believe that we should not wait until 2015. And the reasons are that we see these changes as actually part of the implementation of the AIA. In fact, the statutory provision to have such a report, and the language in the legislative history and also spoken by Chairman Smith that already foresaw the need for carefully looking at the scope and provisions of the prior user rights provisions, that this is therefore something that was already contemplated to face now.

Mr. WATT. Mr. Armitage is smiling. It sounds like he has been in the trenches between the two interests that are debating this before, so let me get his opinion on this touchy subject.

Mr. ARMITAGE. If your desire is to split the difference, I am probably the wrong person to ask that question. This is the 20th anniversary of my first appearance before this Subcommittee testifying on the issue of prior user rights, and frankly I thought in 1992 it was time to have the features of a prior user right law in our patent law in the way Mr. Lang has described them.

Mr. WATT. So you are biased here?

Mr. ARMITAGE. I am quite biased, but I did give the same testimony in 1995 and 2006 so I don't lack consistency on the issue.

Mr. WATT. Okay. All right. Well, given the fact that it took us 6 years to get to an agreement that got the AIA passed, I guess my parting words should be to Mr. Lang and Dr. Vaughn—it seems to me that if we are going to make any technical modifications of the kind that you suggested, it might be necessary for the two of you all to reach some kind of agreement about this.

So, otherwise we will be stuck in place. The default, generally for Congress I have found, is to do nothing, and I have found that is even more true for the Senate, by the way, than it is the House. But that is a subject of another day.

But, maybe I should suggest as my parting comment that maybe the two of you ought to talk some more about this and see if you can reach some kind of agreement about it. Otherwise, I think we are stuck, kind of where we were leading to the passage of what we now have in the law.

I yield back, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman.

I will recognize myself. Mr. Armitage, from a business perspective, what is the greatest benefit of the prior user rights defense?

Mr. ARMITAGE. To be perfectly honest, I think the greatest benefit of the prior user right defense is it helps guarantee integrity in the patent system. I think, as I pointed out in my testimony—written submission testimony, one of the issues that you face in any competitive environment is not all competitors at all times have the highest level of integrity.

Right now, almost every country who manufactures things in the United States has a global workforce. We know that there are some of our competitors who in fact hire our employees not for the right reasons, but to do a bit of industrial espionage. And one of the things that you need to worry about in a patent system, particularly the one we will have under the AIA, is that if we have built a plant around some key trade secret technology, and by some nefarious means, one of our competitors knows exactly what we are doing in our plant, and can start out——

Mr. GOODLATTE. By that you mean a plant here in the United States?

Mr. ARMITAGE. A plant here in the United States.

Mr. GOODLATTE. So the provision makes it more likely that your company in the future will be able to continue to manufacture in the United States without the threat of frivolous litigation?

Mr. ARMITAGE. There is no way to defend ourselves efficiently or effectively without a prior domestic commercial use defense, such as in the AIA. And you are basically giving a 1-year grace period.

Mr. GOODLATTE. Got you.

I got a bunch of other questions here.

Mr. Lang, Cisco is a company that operates around the globe. You work with and sometimes share proprietary information with subcontractors and local partners. Is there still a fear of trade secrets finding their way into patents sought by your foreign competitors?

Mr. LANG. Yes, absolutely. And that is a key reason why a robust prior user rights system to us is important as a means of competitiveness against foreign companies, of which we have some very important ones.

And, under the previous first to invent system, we had the notion in the law that if we were the first to invent, and we brought a product to market without abandoning, suppressing or concealing it that what we had done would serve as prior art. Not only as the defense for us, but to invalidate the patent.

Whereas under a system that is first to file, which we have moved to now, without prior user rights, the work that the—the trade secrets that we give up can then be used as a basis for other people's patents that will then be used to attack us.

Mr. GOODLATTE. And, again, it makes it more likely that your company in the future will continue to be able to manufacture in the United States without the threat of frivolous litigation?

Mr. LANG. Yes. And it extends even beyond manufacturing to the fact that we are a very large U.S. innovator that invests over five billion dollars in research and development.

Mr. GOODLATTE. And continue to do that research and development in the United States.

Mr. LANG. Yes.

Mr. GOODLATTE. Okay.

Mr. LANG. Some of it is spent in the U.S., and we have many significant foreign competitors that we need this provision for.

Mr. GOODLATTE. And Dr. Vaughn, your organization represents universities, which increasingly seek to commercialize their discoveries through the creation of start-up companies. How will the proposed changes affect the challenging and risky environment that university-based start-up companies typically face as they seek to translate university discoveries into products, companies and jobs?

Mr. VAUGHN. Well, I think that our concern about prior user rights at the outset was a preference for the public disclosure of patents and the possibly chilling effect of being able to license those if there was a broad set of products developed by trade secret that would be immune from the assertion of patent rights.

But we think that the compromise that we reached, which we pursued both because we wanted the bill passed and because we

came to realize the importance of trade secret protection through prior user rights, sets the right balance.

The proposed changes that Mr. Lang has recommended, we are concerned that those would then move this compromise back to the area, bringing in certain factors in a prior user rights scheme that would in fact make it more difficult for us to license our patents.

They are early-stage, high-risk; they are going into often undercapitalized start-up companies. If those companies trying to raise additional capital have to deal with the specter of a market that they may not be able to manage by the assertion of patent rights, the ability to exclude by virtue of these immune trade secret products, that is going to greatly complicate our ability to license.

Mr. GOODLATTE. I have another question for you. It is clear the universities are a hotbed of invention and innovation in America. When universities license their inventions, how do they determine who to license to? Is it simply a business decision, or do universities carefully look at who can best help take the innovation to the next level?

Mr. VAUGHN. It is very much the latter, Chairman Goodlatte. The universities see as their mission taking the basic research that taxpayers have funded, and moving that into the commercial sector for the benefit of the Nation as a whole.

So, we have developed some very sophisticated technology transfer offices. They are working constantly with industry, seeking those companies that can develop the promise of this basic research and turn it into useful products.

Mr. GOODLATTE. And one more, for Mr. Armitage.

How would you compare U.S. prior user rights under the AIA relative to our key trading partners? Is it superior, roughly equivalent, inferior? What is your view?

Mr. ARMITAGE. If we made the three changes that Mr. Lang talked about in his testimony, we would be at a par with what I think the best of the best of foreign country prior user right provisions provide. Right now, I think as the PTO report clearly lays out, we are behind where other countries are in terms of, I believe, striking the right balance.

Mr. GOODLATTE. Thank you.

The Chair recognizes the gentlewomen from California, Ms. Chu, for 5 minutes.

Ms. CHU. Thank you, Mr. Chair.

Mr. Lang, you argue pretty forcefully for the expansion of the prior user rights defense to include substantial preparation. Could you offer specific real world examples, and why is it so important to your business?

Mr. LANG. Certainly. So, at Cisco we and our peer companies in the CPF, we develop many complicated products, and they begin with an idea, but between the idea and coming to the marketplace, come many steps of the design, development, building prototypes, testing them, and finally bringing them to market.

We want to make it absolutely clear that all of these steps, the substantial preparation for, are counted as part of commercial use. And we seek this change to the language, and the other changes we seek do not affect what we see as the basic compromise inherent in the prior user rights legislation that brought the universities

on board, which was to actually carve university-based inventions out of the prior user rights language.

Ms. CHU. While some might argue that the lack of substantial preparation standard would create a greater burden on manufacturers because it might be their manufacturing process itself that makes up their "secret sauce", at a time when American manufacturers are struggling with the world economy, it would seem to me that our patent system must give them equal protections.

Do you believe the—that U.S. manufacturers are harmed vis-?-vis their foreign competitors without the substantial preparation standard?

Mr. LANG. I fully agree with that, and at Cisco we face significant competition overseas. And, we see that going through the PTO report and its excellent analysis of prior user rights provisions around the globe in key industrial countries that virtually all of those provisions contain substantial preparation or something akin to it to protect the steps that I outlined in design and development to make sure that that activity counts as commercial use and is not then later attacked by harassing patents.

Ms. CHU. Okay. Thank you.

And I wanted to pursue the questions that were previously asked about the impact that any expansion of prior user rights would have on the universities. I know this was a big issue that last time this Committee had a hearing on intellectual property, and I asked the witnesses whether there was any sort of compromise that could be reached between those supporting prior user rights and those with concerns, which was mainly the universities.

And ultimately this Committee adopted the compromise that gave the university carve-out.

So I would like the opinion of the panel on this, particularly Mr. Lang, and then Dr. Vaughn.

Mr. Lang, would the expansion of prior user rights create any new or additional risk for universities, specifically the substantial preparation standard?

Mr. LANG. We do not see any additional risk or damage to university interests from the modifications that we are asking for, and that is in large part because the compromise that was set carves out university inventions from the effect of prior user rights. Nothing that we are asking for affects that carve-out.

Ms. CHU. Dr. Vaughn, your organization did support this compromise, the university carve-out, and given the broader stakeholder ideas that the prior user right defense needs to be expanded, do you think that this compromise carve-out will continue to work for your community?

Mr. VAUGHN. Well, Congresswoman Chu, I would describe the compromise differently from Mr. Lang. There was an earlier version of the provision, which had solely a university carve-out, and as I indicated, that is the most important provision, but it wasn't until several other factors were added that the university community was comfortable making a change from a total opposition to prior user expansion to a compromise that included a year look back, commercial use instead of substantial preparation—those were parts—they were heavily discussed provisions, and were part of the compromise.

And, I do think if there is a need to reevaluate those, that can be something that would be put in the 2015 report, but the compromise that we agreed to had those provisions and those were important parts of it.

Ms. CHU. And other panelists, Mr. Crouch and Mr. Armitage?

Mr. CROUCH. You know, one thing we have been discussing here, right, is this potential fraud where someone finds a trade secret that a U.S. manufacturer has, takes it abroad and then applies for a U.S. patent, and then comes back and goes after the U.S. manufacturer, right?. And that is kind of the fraud that Bob Armitage described.

If we add the language of substantial step, right? Or something akin to that, I worry about fraud going the other way in that we have someone that who is now claiming prior user rights where they say, look, 10 years ago, I started down this substantial step, and I kept it a trade secret this whole time, and here, I will go back to my file room and discover it, right?

And they produce papers to discover it, but I think there is a real risk of fraud there, and certainly with the patent system and any system where you have this ability to back-date materials, we have experienced fraud.

And it is a struggle for the courts to deal with that, and so I would hope that if we—any compromise that we come to, that something that needs to be considered is the potential for fraud in both directions.

Mr. ARMITAGE. I think one of the difficulties this Subcommittee will have is everyone on this panel is absolutely correct. We need a patent system that if we make changes to it, doesn't provide an opportunity, much less an incentive, for fraud. We, in the America Invents Act, had a carefully crafted compromise, and the provisions currently in the law and prior user right reflect that compromise. We know from Dan Lang's testimony that we don't have a prior user right provision that is as effective as exists in foreign countries. That's a competitive disadvantage, and at some point that needs to be addressed.

So I guess the real question for the Committee is when.

Ms. CHU. Thank you.

I yield back.

Mr. GOODLATTE. I am going to follow up on the question of the Ranking Member and say, are you better off now than you were before this bill, but you would like to still get to a better place, or—I know you want more, and I know some people were a little hesitant about that, so——

Mr. ARMITAGE. If you own a patent today in the United States, and you are in the business of getting more patents, it is part of your business model, you are much better off with the America Invents Act. It is a remarkable patent reform law.

Mr. GOODLATTE. Including in the area of prior user rights defense?

Mr. ARMITAGE. Including in the area of prior user rights.

Mr. GOODLATTE. Thank you.

I now recognize the gentlewoman from California, Ms. Sánchez, for 5 minutes.

Ms. SÁNCHEZ. Thank you, Mr. Chairman.

Mr. Armitage, can you speak as to how the prior user rights provision in AIA compares to that of our major trading partners, and how do you think that might impact our trade with them?

Mr. ARMITAGE. You know, I had a chance to read the actual prior user rights statutes in several countries—Korea, Germany, Japan and China, maybe Mexico, one or two others. They are very simple provisions.

Fundamentally, what they say is, if you have made substantial preparations for commercialization, or you have commercialized your invention, then nobody can touch those operations if they seek their patents even a day after you have completed those substantial preparations.

What we have done in our law are three things, and Dan has explained them.

We have a subject matter limitation, and only some kinds of patents are under the prior user right law.

Second, we have a 1-year holdback.

Three, we require actual commencement of commercial operations.

Even if you spent a billion or two billion dollars building a plant, and you can't operate it until Monday, if the patent's filed on Friday, you get no benefit of our prior user rights statute.

Ms. SÁNCHEZ. Thank you for making that clarification.

I don't have any more questions. I will yield back to the Chair.

Mr. GOODLATTE. I thank the gentlewoman.

And the gentleman from Georgia, Mr. Johnson, is recognized for 5 minutes.

Mr. JOHNSON. Thank you, Mr. Chairman for holding this very important hearing.

I would ask Mr. Armitage, and also Mr. Lang—I will note that in both your testimonies, you both suggest some changes to the prior user rights defense to bring the U.S. in line with other countries like Germany, Japan and South Korea. Mainly, the three changes are relating to protecting all forms of invention, providing the defense, not only to products that are in commercial use, but also to protect substantial preparations for commercial use, and eliminating the 1-year holdback requirement.

How do you respond to the university community that has concerns about these changes?

Mr. LANG. Well, I would go back to my earlier comment that a part of the compromise—and you know, we just heard from Dr. Vaughn on the other significant elements of the compromise—but an important part of the compromise was carving the universities out and university-based inventions out of prior user rights, so we believe that their interests will be unaffected.

Also, we see this as very important, the competitive differentiation versus our peers around the globe, that these American companies are affected by the disparate impact of U.S. prior user rights law on U.S. companies as opposed to the prior user rights statutes around the world, you know as we have outlined and as we have catalogued and their impact on foreign companies and the protections that foreign companies enjoy under those statutes.

And I would also add that as far as small, innovative businesses, I mean, the PTO report that is, you know, very thoughtful in its

economic analysis and did not find any negative impact on innovation of prior user rights, and we believe that the changes and the modifications that we are proposing will not disturb that.

As a part of the PTO report process there were public comments submitted by a range of companies including companies that are small businesses and the Greentech industry—a company that is a space exploration start-up, and they were very consistent with and supportive of our view of prior user rights, and how they should proceed.

So we believe that the changes that we are advocating are very positive for American innovation over a range of industries and businesses, and we believe that they will make American industry and American manufacturing more competitive with those around the world.

And we believe that that will be accomplished in a way that encourages and does not discourage innovation.

Mr. JOHNSON. Thank you.

Mr. Armitage, you have pretty forcefully made the case of us modifying the law so as to include substantial preparation as a protective vehicle for establishing prior use.

Is there anything else you would like to say about that?

Mr. ARMITAGE. Just one comment, perhaps, about the "valley of death". And this was the comment that there are small venture start-up companies that may be hurt by the prior user rights.

The way I look at it, companies like Cisco and Lilly actually are the ones who acquire these companies, and invest in these companies. And for us, those companies that are start-up ventures—that even those companies that depend on a strong patent system because we are really buying patent rights—prior user rights actually make those investments more valuable to us, make them more valuable to the small ventures themselves because they eliminate the possibility that we may have someone on the verge of commercialization where we want to buy the technology, bring it to market.

We don't have to worry that some belatedly filed patent is going to come in and sit on top of the actual way they have tried to commercialize that technology, and require us to get into patent litigation or engage in third-party licenses in order to commercialize.

If you believe in a strong patent system, a good prior user right is a good way of making that patent system work more effectively with a trade secret system that's essential to I think almost anybody who commercializes technology.

Mr. JOHNSON. Okay, thank you.

Professor Crouch, do you have anything you would like to contribute?

Mr. CROUCH. Dovetailing with what Mr. Armitage mentioned, I think there is one minor area where the U.S. rights are broader than many other countries and that is that we allow for an increase in volume. That is, if the original prior commercialization was at a small volume that entity can continue to sell the same product, and increase the volume, right? And I think, in my estimation that is also a good provision for many start-up companies who have the idea of starting off small, and eventually growing into a larger company, right?

Or perhaps have the way out of getting bought out by Lilly or Cisco where those companies want to rely on the prior use defense, and can only do so if we have this volumetric flexibility.

Mr. JOHNSON. Dr. Vaughn?

Mr. VAUGHN. Bob discussed a circumstance where a small, start-up company is acquired by a bigger company like Cisco or Lilly, but there may be many circumstances where a start-up company wants to launch an independent and self-sustained venture, and we are concerned that an expansion of prior user rights, which would be affected by the proposed changes that are in discussion here, going from commercial use to substantial preparation, eliminating the 1-year look back, could run a risk of creating trade secrets that otherwise wouldn't have been created—that are built in anticipation of a forthcoming patent that is closer in temporal proximity, creating a market situation where the start-up is now going to have an inability to assert its patents and a situation that wouldn't occur if commercial use had to be required a year before.

Mr. JOHNSON. Would substantial preparation?

Mr. VAUGHN. Substantial preparation—the problem there is both that it is—it makes—it is a vaguer standard and as I mentioned earlier, and Director Kappos had indicated, because of that vagueness, you have a much higher likelihood of getting into litigation, of the problems of discovery.

Professor Crouch mentioned the difficulty of back-dating and opening up the possibility of fraud so we are concerned that getting into vaguer circumstances, bringing the prospect of prior user rights closer to a patenting activity can create a climate where start-ups are going to have more difficulty raising capital for independent development and as a matter of process just to go back to the point that we went, I think, as a community in good faith a long way from flat-out opposition to prior user rights to having the substantial expanded provisions we have.

If that needs to be reexamined, I think we should take the time, get the evidence, and do it with care.

Mr. JOHNSON. Mr. Lang?

Mr. LANG. If I might add, I mean, we see substantial preparation as not some extra new defense that was never previously available under the law, but rather in a sense a partial restoration of protections that we enjoyed in the first to invent regime, and that the development process that I outlined previously, if it were followed, we would have been entitled to a date of conception as a date of prior art that would actually invalidate the patent.

And in seeking substantial preparation as a clear example of commercial use that would entitle us to a prior user right we are wishing to protect that work that we do as against a patent that would be later filed on our own work, and would be used to disrupt our activity.

A patent that would be generated by somebody who is out there in the marketplace could be a foreign entity who is looking at our—analyzing our external moves and guessing what we might be working on internally, able to devote their resources to filing patents and patent applications and then able to harass us with those, even though it is our work that started first, and that work needs to be counted in substantial preparation.

Mr. GOODLATTE. The time of the gentleman has expired.

The gentlewomen from California, Ms. Waters, is recognized for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

I would like to thank all of our panelists that are here today.

Mr. Lang, are you speaking on behalf of the Coalition for Patent Fairness?

Mr. LANG. Yes, I am.

Ms. WATERS. And, that includes Adobe, Apple, Cisco, Dell, Google, Intel, Intuit, Micron, Oracle and RIM—all of those companies?

Mr. LANG. I do not—I believe that it includes all of those companies with the exception of Apple as of today.

Ms. WATERS. I see. I am sure you are aware of the article that is causing so much discussion that appeared in the New York Times entitled, "How the U.S. Lost Out on the iPhone Work". In that conversation, the President—well, in a conversation with some of the representatives of these industries, and particularly to Apple, I think, the President asked Steve Jobs about what it would take for Apple and presumably other tech companies to repatriate manufacturing jobs back in the U.S. And the answer was that those jobs are not coming back to the United States.

As you know, most of the Members of Congress wish to have our companies in a position of profitability. We want our companies to make money, but we want our companies to hire the people in this country. We know all of the arguments about how it is not economically feasible to do that anymore, so as we talk about the competition that you face and why it is important for us to expand user rights, etc., you want us to help make you more profitable, but what does that do in terms of answering this question of whether or not you are going invest more in job creation?

When I take a look at Cisco, Cisco will double its manufacturing in China. That was what John Chambers said, the CEO. The company will inject 350 million into start-up investments and provide up to 400 million in customer financing—the Cisco Systems Capital China. It will also open another 300 of its networking academies to train 100,000 students on networking technology as part of an MOU—that is a memorandum of understanding—with the Ministry of Education under which will also donate 6 million in networking equipment.

Now, I can remember some years ago having this discussion with Cisco about training, and simply, in South Central Los Angeles, because when you were in the bubble a lot was going on in Silicon Valley and those areas a lot of jobs were being created, and we thought that perhaps it made good sense that if our universities were not turning out the kind of people that you needed to do the jobs, that perhaps Cisco and other companies like Cisco, could have these academies, or right on their own campuses to help train and develop young people to be involved in this new technology—that was not thought of as something that could or should be done.

But I see it has been done abroad. What can you say about that? Do you think jobs have gone forever? What are you and your cohorts willing to do about bringing jobs back to the United States, and how can we help you to be more profitable even though Apple

was number one in the country—made more money than anybody, including the core manufacturers, etc.?

So I kind of asked you a lot, but I would just like to hear what you think about that, Mr. Lang.

Mr. LANG. Sure. Thank you, Congresswoman Waters. So, Cisco is a vigorous U.S. competitor in a foreign marketplace, and I am here as the patent expert, but Cisco, of course, has an interest in a vigorous U.S. economy that is going to help bring us to full employment.

The issue that we are talking about today is prior user rights, which is one of many policies that affect employment in the United States. And we—you touched on some of our investments in China. We have a—obviously, like many of our peers in the IT industry, we have a global——

Ms. WATERS. Could you talk specifically about the training that you do in China?

Mr. LANG. I am sorry?

Ms. WATERS. The training that you do in China. The money that you are investing in training Chinese to do the work that you need.

Mr. LANG. Yes, I am not actually familiar with our specific training investments in China. I know that we operate a program of Cisco network academies, which exist in the United States, as well as other countries of the world.

In the United States, I will say—well, globally, we spend five billion dollars on R&D and 80 percent of that is in the United States.

And also, we employ 30,000 people in the United States. The United States is very significant, you know -

Ms. WATERS. How many do you employ offshore?

Mr. LANG. Excuse me?

Ms. WATERS. How many people do you employ offshore?

Mr. LANG. I don't know the exact number.

Ms. WATERS. You know, domestically, it is about 30,000.

Mr. LANG. Yes.

Ms. WATERS. You think it is more offshore, collective, totally offshore?

Mr. LANG. I am not sure sitting here, no.

Ms. WATERS. You are not sure of that number?

Mr. LANG. I do not have that number.

Ms. WATERS. Do you think that as we talk about—let's go back to the question the President asked. Do you think that—what can be done to get these jobs back to this country?

Mr. LANG. Well, again, I have come to—as the patent expert, to testify on prior user rights. However, I know that our company has advocated a number of issues including prior user rights, and changes to the patent law, but also issues concerning taxation, education, etc. And, I think that there is a variety of policies that could be followed to encourage employment.

Ms. WATERS. Do you think it is legitimate for us ask you the question if you want us to help make you more competitive, more profitable, is it not reasonable for us to ask when will we see the results of that with more investment in this country?

Mr. LANG. Yes, that is a reasonable question to ask. The reason that we are here advocating for prior user rights or under prior user rights is a part of that discussion—an important part in our

view in terms of strengthening and balancing our patent laws to encourage innovation in the United States.

Ms. WATERS. Well, if I may say that many of us would love to support you in expanding the user rights and other kinds of things to make you more competitive, but there must be a direct relationship to job expansion and creation in the United States.

And, I suppose, if we are going to continue this discussion that at some point if you can relate to that and you can identify how what we do will help you to be more competitive and more profitable, we certainly will jump over all kinds of hurdles in order to be of assistance and supportive.

With that, I yield back the balance of my time.

Mr. GOODLATTE. I thank the gentlewoman.

I have an additional question for the panel and I know that the Ranking Member does as well. We will see if anyone else does after we do those.

And I will address this to all of you, starting with Mr. Armitage. Could the university exemption provide an opportunity for gamesmanship whereby companies could arrange in advance of an invention an agreement to assign that invention to a university, and take back an exclusive license right at a very low cost and avoid applicability of the prior user right?

Mr. ARMITAGE. You know, I think that is a theoretical possibility someone could try doing that. I think in the real world it has virtually no prospect of succeeding.

Mr. GOODLATTE. Why do you say that?

Mr. ARMITAGE. Well, first of all, understanding how universities operate. They're really not in the business of doing contract research to reverse-engineer somebody else's trade secret so they can file patent applications so they can license back the technology. We do this, and we want to be in a business of manufacturing a product. We may have to engineer everything that is needed to be known to how to manufacture.

We may be reverse-engineering somebody else's trade secrets, but I doubt that any university in John's membership wants to be used as that kind of reverse-engineering factory, to be honest.

Mr. GOODLATTE. What if the company comes to the university without disclosing that as their objective, but says, hey, we got a great idea. We want to make this arrangement with you?

Mr. ARMITAGE. So, let me give you an example. We perform the same reaction ten thousand times to figure out the optimal temperature, number of reagents, type of reagents and create trade secret technology about how best to do that. I know of no one in a university who would want to take on that kind of dull, mundane research to optimize the way we mix chemical A and B at this temperature, this concentration, for this long for the sole purpose of filing a patent application that they could license back to us. That just isn't the innovative, cutting edge thing that any professor I have ever been in contact with would consider doing for money or otherwise.

Mr. GOODLATTE. Mr. Lang?

Mr. LANG. Yes. If I might just spend a few seconds addressing one of Congresswoman Water's questions about networking acad-

emies. We, in fact, operate over 100 networking academies in California that include 13,000-plus students.

Now to get to the question of the potential for gamesmanship in the university carve-out. I agree with Mr. Armitage that the universities represented by Dr. Vaughn would not willingly enter such arrangements to exploit the carve-out, and we are not here to suggest changes to the carve-out which we realize was an important part of the compromise that was shaped last year in prior user rights.

That being said, I do not underestimate the creativity of my colleagues in the legal profession to find loopholes and try to exploit them, and it could be that if that problem arises we will need to address that issue in due course.

Mr. GOODLATTE. Or as a part of any changes that you are recommending to us today to make sure that that doesn't happen as a result moving forward?

Mr. LANG. Like if there is a—we are not proposing—we are proposing three modifications to be done as soon as possible.

This other category I would suggest is something that may need further exploration.

Mr. GOODLATTE. We just have to take into account that as we enhance prior user rights defense, we have to take these things into account ahead of time rather than after the fact, and find that somebody has been creative and therefore we have got to go back and close. We need to know whether that's a likely problem or not.

Dr. Vaughn?

Mr. VAUGHN. I think it is an intriguing and disconcerting issue that you raise. And as Bob said, it probably is a technical possibility. It is so at variance with the mission of universities that I can assure you that when we are in the process of implementing this, and it goes to the earlier question you asked about what kinds of industries do we want to work with, we really have a public mission of paying back the taxpayers that funded so much of our research to benefit the Nation.

And I can just assure you that as a matter of policy and procedure our institutions would assiduously avoid any kind of arrangement like that which just goes—runs totally counter to our public mission.

Mr. GOODLATTE. So you would have to be fooled into doing it, if it were to happen. It certainly wouldn't be an objective of the university.

Mr. VAUGHN. Absolutely not.

Mr. GOODLATTE. It might be an objective of the——

Mr. VAUGHN. And I think our technology transfer and general counsels are smart enough. It would be very hard to fool them.

Mr. GOODLATTE. Good.

Professor Crouch?

Mr. CROUCH. I agree with all that is said, and I think that we have—in the law as it now stands we have protections against that in terms of first the good faith element and in addition the restriction on deriving your inventions from someone else that are already there in the prior use statute.

Now, what is true though, is that since universities aren't subject to this prior use that does make them marginally more attractive

for people to invest in, right? Especially if you are going to invest in the area of research where you think somebody else might also be doing competitive research. And so, if you bring a university on board, then you are at a competitive edge especially when you have a patent race going on.

And so that's not fraud, but it is—but it does shift the landscape in favor of working with universities, and that is really the point of why this was put in and that is why universities wanted this provision in there.

Mr. GOODLATTE. Thank you.

Mr. Watt?

Mr. WATT. So, here is my situation. I am somewhat sympathetic to the three suggestions that Mr. Lang has suggested, but I also am politically aware that in order for anything of that kind to move forward at least on any kind of quick timeframe or modestly quick timeframe, there would have to be a very broad agreement, and that agreement would have to bring the universities along and be palatable to them.

So, let me ask this question, and I am just kind of talking off the top of my head. I am looking for sources of compromise here as I generally am to try to make something happen. Substantial preparation is about substantial preparation for commercialization, I am correct about that, am I not?

It seems to me that in a university context, substantial preparation could be really advantageous to universities because they are doing a bunch of substantial preparation not necessarily initially in preparation for commercialization, but they are putting a lot of time and effort and preparation into whatever the venture is even before they get to thinking about commercializing it, I presume.

So what would you think of a compromise that as far as universities are concerned might define substantial preparation as a little bit more generous than just substantial preparation for commercialization. Would that be something that might be the starting point of something that might lead to a compromise?

Dr. Vaughn, Mr. Lang, Mr. Armitage, Professor Crouch? That is the only question I have.

Mr. VAUGHN. It is, I understand, your question, Congressman Watt, that the substantial preparation might also include activities by the university in the course of their commercialization.

Mr. WATT. Or non-commercialization.

Mr. VAUGHN. Yes, right. I think the concept of substantial preparation for commercialization here provides, applies strictly to the private sector, that is it would apply to universities if we were manufacturing things, but we don't.

So, we create discoveries through taxpayer-funded basic research. Our job is to move those early discoveries into the commercial sector so that they can develop them and the substantial preparation that prior user rights is being discussed is all in the commercial sector.

But in the interest of, I think, your broader goal of can we try to reach an agreement where we have a difference, I would just say two things.

In terms of process, we did have a compromise that was very difficult to achieve, that universities moved a long way to support,

which involved not only the exemption of university research—university discoveries from the assertion of prior user rights university patents, but also the 1-year look back and commercial use, not substantial preparation.

But universities are—the members of AAU and beyond work so closely with Cisco, with Lilly, with these companies, we are allies in so many things. I think we cannot and should not ignore their concerns.

I have stated that I think the right process is to leave this compromise in place. Let the PTO examine with better evidence in 2015 the impacts of this. If there is a need to do something further, I do think we should move with caution. I would assert that there is no country in the world that has a more robust university industry, technology transfer, commercialization process than this country.

The impact of Bayh-Dole has been enormous. Other countries are trying to build that, but I think our universities are more productive in commercialization than any other country, and when I hear from our campus experts a concern about too broad an expansion of prior user rights, we need to listen to them carefully, but we also need to listen to our allies in the commercial sector.

So I think if there are problems, we should be open to discussing those, but doing it cautiously over time. But that could move us to the compromise—to the agreement that you are seeking.

Mr. WATT. Anybody else want to add to that, or should I just go away and let you all work on it?

Mr. ARMITAGE. Well, as Chairman Goodlatte knows, when we were doing the AIA up until the last minute there were things that needed further work. I think your work and the work of your staff on supplemental examination was something that looked like there was no way to bridge the gap.

At the eleventh hour we finally found a way to do that. We have a compromise here, I think, that was a good, sound compromise.

On the other hand, if someone asks this panel to come and say is this the way the law should be for all time, in all good conscience, I cannot say yes. My view is that we need to continue to look at this and find ways to be competitive with the rest of the world on this provision. I heard very clearly that there may be a potential for fraud or abuse with a substantial preparation standard that is too loose. It seems to me that is a very productive area, where as on other issues, we find the right concepts. We find the right words to make sure it can't be abused by anyone.

I think it is much more difficult to compromise on the issue of the 1 year. We already have built into the prior user rights statute full protection for anybody who publishes on an invention, not just files a patent application on it so that it has protections that exist nowhere else in the world for the patent owner.

So I don't know how to compromise on the 1 year, but I think that maybe on the other aspect we could get our heads together and do something quite constructive.

Mr. WATT. Go ahead.

Mr. LANG. Now, I will add that the—to reinforce Mr. Armitage's point that the existing prior user rights statute already incorporates many aspects of compromise that we are not seeking to dis-

turb the publication as being an effective date of comparison against the prior commercial use, things like restrictions on transfer of the right and the university carve out itself.

That being said, I think that our intention here is clear to be able to get to a prior user rights regime that is an improvement over the present one in the bill in the sense it leaves us at no competitive disadvantage compared to our foreign peers, and if there are other ways of accomplishing that on the specific three points I mentioned. Although the 1 year is difficult to understand how there would be an alternative if there are other ways of accomplishing those and leaving us in a position where we are in a similar position protected by a prior user rights regime in the U.S. comparable to that our foreign competitors enjoy, we are certainly willing to explore those.

Mr. CROUCH. Yes, I think the problem is the universities have patents, but they are not benefitting from the prior use exception because they are not commercializing.

And I think one way to shortcut through that is potentially just to give them the right to transfer, or the ability to transfer a prior user right to whoever the spinoff company that they handover the technology to. So if they made steps in their innovation, and steps toward commercialization, if then at that point when they hand that off to a commercial venture that that new commercial venture both gets the patent rights and gets whatever prior user rights are available then I think that potentially draws them back into a parallel scenario as other manufacturing entities.

Mr. WATT. Well, I thought that might be close to what I was suggesting, but okay, I am not going to ask anymore questions.

I yield back, Mr. Chairman.

Mr. GOODLATTE. I thank the gentleman.

Does this prompt any questions from Mr. Johnson or Ms. Waters?

Mr. JOHNSON. Yes, I do. I am just sitting here thinking. This university carve-out benefits universities and I was thinking about how the private sector has come into our universities or actually our institutions of higher education, I believe, is how we referred to our universities—come in endowed, various activities and placed requirements for the use of the endowment, hiring decisions, editorial control as the price, or is there compensation, if you will, for making the endowment or the investment in an institution of higher education?

And that would seem to offer a unique opportunity for say, an energy-related business, to endow a professorship or a school of X with funding to produce a certain process and then they could perhaps benefit from not being subject to the prior use defense.

And I am also thinking in terms of higher—institution of higher education. When we think of that we think about Harvard, Yale, Spelman, Morehouse, Howard, Clark Atlanta University, the University of Pennsylvania, University of Connecticut, UCLA, those kinds of institutions, but yet you have no other institutions of higher learning. You have private, for-profit institutions of higher learning—I wonder if they benefit also from the prior use carve-out, and I wonder whether or not the carve-out under those kinds

of circumstances could be used to perpetuate fraud, or some kind of an abuse of the patent system.

It's very intriguing, this issue, as I sit and listen to more of it. Anybody have any comments about what I said?

Mr. VAUGHN. There is sort of a two-part question there, and, first of all, the research universities that conduct both education and research have an enormous number of very productive relationships with industry. You mentioned endowments. Universities love to try to build their endowments from donors, sometimes from industry. They all have fairly formal, circumscribed conditions under which they will accept gifts. Universities would love to have open-ended donations. There are often conditions put on, but——

Mr. JOHNSON. Let's say a gift is conditioned upon the denial, the scientific denial of global warming.

Mr. VAUGHN. Any respectable university would refuse that gift flat-out.

Mr. JOHNSON. Well, I mean there are a lot of—I could name names in terms of the funders of these endowments, and also the universities that accept them and conform their actions therewith. Private, non-profit standard type universities, right here in Washington, D.C., in fact. I am thinking of one with a name that is very—that brings back a—that has a historic connotation to it. You know, you would never think they would be corrupted intellectually, but it appears that that they may. I am not going to call the name, but they have fallen victim to this phenomenon.

Then also on top of that, you have the non-profit—I mean for-profit—institutions of higher education, some of which even advertise on TV, and they may not have the kind of standards in terms of enrollment, education requirements, prerequisites. They may just be a place that accepts federally guaranteed student loans, and churns out people who are not equipped to deal in our current marketplace. These are my concerns.

Mr. GOODLATTE. I am going to interrupt. The gentleman's time has expired, and this is a discussion that we—could go on for quite some time. But I am going to allow him to discuss that with you at the conclusion——

Mr. VAUGHN. Can I just make one quick comment on that?

Mr. GOODLATTE. Very quickly.

Mr. VAUGHN. With respect to the prior user rights and the university exemption, the legislation as written clearly limits it to not-for-profit. No for-profit institutions will qualify for it.

Mr. GOODLATTE. Ms. Waters? Did you have some questions you would like to add?

Ms. WATERS. Well, not really. I would just like to wrap this up by saying that—to Mr. Lang, that U.S. innovation policy includes patent law, antitrust, tax and immigration. I don't see it separately. So, I, you know, in raising these questions, I would raise it with representatives because I think that representatives from any of these companies should understand that when we talk about jobs and jobs creation and our U.S. innovation policy, we are talking about all of these things not just patent law. Not just antitrust, but tax and immigration also.

And I am familiar with the academies in the United States, and how they work in our elementary schools. And what I am talking

about in China is very different. It is the training of people for jobs now, similar to what was described in the New York article with the dormitories and the tea and biscuit and hundreds of thousands of employees available around the clock. I am really talking about that kind of atmosphere, and whether or not the training that you do there is training for those kinds of jobs.

And I will just leave that for the time being, but the reason I mention it is because exportation of jobs offshore for cheap labor is increasingly a highlighted issue in this country, and it is going to become even more so.

And so I think it needs to be thought about always as you enter into these discussions about how we are helpful or not helpful in making our companies more competitive and why we are doing that, and what are the results of that.

So, I would like you to just keep that on the radar screen, and advise the company that this came up in the discussion as with the universities.

When I talked about doing whatever is necessary to support our companies, I certainly wasn't talking about that to the exclusion of our universities. I think you have a very important role to play, and I think that Congressman Mel Watt got you to the point in the discussion where not only did you talk about how well you know each other, and how you worked together and how you helped to forge the compromise that is in law now.

And you can continue to work, but when you raise, Professor, the idea of the transfer of prior user rights onto the companies I think that is very attractive so, I am hopeful that whatever happens, it will not be to the exclusion certainly of the university.

So I thank you, Mr. Chairman, for the additional time, and I yield back.

Mr. GOODLATTE. I thank the gentlewoman.

And I would like to thank the witnesses for their testimony today.

Without objection, all Members will have 5 legislative days to submit to the Chair additional written questions for the witnesses, which we can forward and ask the witnesses to respond as promptly as they can so that their answers may be made a part of the record.

Without objection, all Members will have 5 legislative days to submit any additional materials for inclusion in the record.

And with that, I again thank the witnesses, and declare the hearing adjourned.

[Whereupon, at 12:26 p.m., the Subcommittee was adjourned.]

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