



CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

April 30, 2009

S. 515
Patent Reform Act of 2009

*As ordered reported by the Senate Committee on the Judiciary
on April 2, 2009*

SUMMARY

S. 515 would amend various provisions of current law that regulate how the Patent and Trademark Office (PTO) awards patents. Among other things, the bill would alter the rule that prioritizes the award of a patent from the “first to invent” to the “first inventor to file.” As a result, PTO would change certain procedures it follows in awarding patents and establish new procedures that would allow individuals to challenge the validity of patents that have been awarded.

Under current law, PTO is authorized to collect a variety of fees for the services it performs. The fee rates are set in statute, and the amounts collected are available to offset the cost of PTO’s operations. The bill would permanently set higher fee rates for certain actions and authorize PTO to set or adjust fees periodically. S. 515 also would authorize PTO to establish fees to offset most of the costs associated with new procedures it must follow when presented with a challenge to the validity of a patent.

Subject to appropriation of the necessary amounts, CBO estimates that implementing S. 515 would have a net discretionary cost of \$3 million in 2010, and would reduce discretionary spending by \$173 million over the 2010-2014 period. CBO estimates that enacting S. 515 also would increase direct spending by about \$3 million over the 2010-2019 period; the bill would have no effect on revenues.

S. 515 contains an intergovernmental and private-sector mandate, as defined in the Unfunded Mandates Reform Act (UMRA), on certain patent applicants. Based on information from PTO, CBO estimates that the costs of the mandate would fall below the annual thresholds established in UMRA (\$69 million for intergovernmental mandates and \$139 million for private-sector mandates, in 2009, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of S. 515 is shown in the following table. The costs of this legislation primarily fall within budget functions 370 (commerce and housing credit) and 750 (administration of justice).

	By Fiscal Year, in Millions of Dollars					2010- 2014
	2010	2011	2012	2013	2014	
CHANGES IN SPENDING SUBJECT TO APPROPRIATION						
Inter Partes Reexaminations						
Estimated Authorization Level	0	11	15	21	25	72
Estimated Outlays	0	9	14	20	25	68
Post-grant Opposition Procedures						
Estimated Authorization Level	0	3	4	9	10	26
Estimated Outlays	0	2	4	8	10	24
Administrative Costs						
Estimated Authorization Level	5	5	0	0	0	10
Estimated Outlays	1	7	2	0	0	10
Pilot Program in District Courts						
Estimated Authorization Level	5	5	5	5	5	25
Estimated Outlays	2	5	5	5	5	22
Offsetting Collections						
Estimated Authorization Level	0	-67	-68	-78	-84	-297
Estimated Outlays	0	-67	-68	-78	-84	-297
Net Changes in Spending						
Estimated Authorization Level	10	-43	-44	-43	-44	-164
Estimated Outlays	3	-44	-43	-45	-44	-173
CHANGES IN DIRECT SPENDING ^a						
Estimated Budget Authority	0	1	1	1	0	3
Estimated Outlays	0	1	1	1	0	3

a. CBO estimates that increases in direct spending under the bill would total \$3 million over the 2010-2019 period.

BASIS OF ESTIMATE

For this estimate, CBO assumes that the bill will be enacted near the end of fiscal year 2009, that the necessary amounts will be appropriated each year, and that spending will follow historical patterns for the agency. Further, CBO assumes that most of the bill's provisions would be effective one year after the date of enactment.

Spending Subject to Appropriation

S. 515 would change the basis that PTO uses to award patents. Under current law, where two or more persons independently develop identical or similar patents at approximately the same time, the patent is awarded to the first inventor established through the examination process. S. 515 would direct PTO, under the same circumstances, to award the patent to the inventor whose application has the earliest filing date. The bill also would establish a new procedure (post-grant opposition) to challenge the validity of a patent and would authorize PTO to collect fees to offset much of the costs associated with that process.

Based on information from PTO, CBO expects that the volume of requests for reconsideration of patents already granted (inter partes reexaminations) would increase as a result of changes S. 515 would make to the reexamination process. Under current law, PTO is authorized to collect fees for those reviews as well. The collection and spending of fees are subject to provisions in annual appropriations acts, and the fees are recorded on the budget as offsets to the discretionary spending of PTO. For 2009, the PTO received a gross appropriation of \$2,010 million, and CBO estimates that amount will be offset by \$1,937 million in fee collections. Assuming appropriation of the necessary amounts, CBO estimates that implementing S. 515 would reduce PTO's net outlays by \$195 million over the 2010-2014 period. Further, CBO estimates that discretionary spending would increase by \$22 million over the 2010-2014 period for a pilot program authorized within the Department of Justice, assuming appropriation of the amounts specified in the bill. In total, implementing S. 515 would reduce net discretionary spending by \$173 million over the 2010-2014 period.

Inter Partes Reexaminations. Under current law, an individual may question the validity of an awarded patent through an inter partes reexamination, which allows both the challenger and the patent-holder to participate in the proceedings by submitting arguments and filing appeals.

There is no time limit on raising an inter partes challenge, however, such challenges may only be brought against patent applications filed after a certain date. S. 515 would expand the universe of awarded patents that could be challenged through this proceeding; as a result, CBO expects that the number of inter partes reexaminations would increase. Further, the bill would require the inter partes proceedings to be conducted by an

administrative patent judge; under current law, these proceedings are conducted by a patent examiner.

Based on information from PTO, CBO expects that around 80 additional employees would ultimately be necessary to handle an increase in patent challenges. We estimate that implementing the changes to the inter partes reexamination procedures would cost about \$9 million in 2011 to hire and train additional staff and \$68 million over the 2010-2014 period. PTO is authorized to collect fees that would offset a portion of the costs of conducting those examinations.

Post-grant Opposition Procedures. S. 515 would authorize PTO to create a new procedure to review the validity of patents already awarded. This opportunity for such a post-grant review generally would be available within 12 months of the date the patent was issued, and would take place in a court-like proceeding in which both the challenger and the owner of the patent would develop and present information regarding the validity of an awarded patent. The bill would authorize PTO to collect fees to offset the cost of this new process.

Based on information from PTO, CBO expects that the volume of requests for post-grant reviews would grow each year once regulations defining the process are complete. CBO estimates that implementing this new process would cost \$2 million in 2011 and \$24 million over the 2010-2014 period, which would be offset by fee collections starting in 2011. The cost would be higher in the early years because we expect that the agency would incur expenses to establish the system before cases would be presented for review.

Administrative Costs. As a result of the switch to a “first to file” principle, PTO would incur additional administrative costs, including updating its information technology systems and training staff. CBO estimates that those changes would increase discretionary spending by about \$10 million over the 2010-2014 period.

Pilot Program in District Courts. Section 15 would create a 10-year pilot program in certain district courts to hone judicial expertise in patent protection cases. The bill would authorize the appropriation of not less than \$5 million a year for the professional development of district judges and compensation of law clerks with expertise in such cases. After 2014, the Administrative Office of the United States Courts would be required to submit two reports to the Congress detailing the progress of the pilot program. CBO estimates that implementing those activities would cost \$22 million over the 2010-2014 period. After 2014, CBO estimates that the program would cost an additional \$31 million.

Offsetting Collections. Certain provisions of S. 515 would permanently extend some, but not all, fee increases that have been authorized in annual appropriations actions since fiscal year 2005. Further, as noted above, the bill would authorize PTO to set and collect

fees for the new post-grant opposition process. Finally, S. 515 would authorize PTO to adjust fees periodically to offset the organization's costs of providing its services.

Based on information from PTO and historical patterns of collections, CBO estimates that those new authorities would increase offsetting collections by \$70 million in 2011 and \$320 million over the 2010-2014 period. Of that amount, \$277 million would be generated through the permanent extension of fee increases, the balance would result from fees related to the increased volume in patent challenges (both inter partes re-examinations and post-grant reviews).

Other provisions of S. 515 would expand the number of patent applications filed in foreign countries that would be reviewed in the course of PTO's examination process. Based on information from PTO, CBO expects that some of the U.S. applications that would be approved under current law would be denied under the provisions of S. 515 because of information made available in the foreign applications. CBO estimates that fee collections would fall by \$3 million in 2011 and by \$23 million over the 2010-2014 period due to the loss of issuance and maintenance fees due after a patent has been awarded. CBO estimates that net offsetting collections would increase by \$67 million in 2011 and by \$297 million over the 2010-2014 period.

Direct Spending and Revenues

Section 12 would change the amount of royalties or income earned by certain contractors that is required to be remitted to the federal government. Under current law, funding agreements between the federal government and contractors operating government-owned-contractor-operated (GOCO) laboratories allow contractors to retain, up to a certain threshold, all royalty and other income earned from patents received as a result of work performed under the contract. Beyond that, 75 percent of royalties or income earned above the threshold must be returned to the U.S. Treasury. The royalties returned to the Treasury are recorded as offsetting receipts (credits against direct spending). S. 515 would reduce that amount to 15 percent.

Currently, only one entity operating a GOCO laboratory returns excess royalties and license fees to the federal government. Over the past several years, the Ames Laboratory, operated by Iowa State University, has returned to the Treasury approximately \$1 million a year in license fees earned from patents awarded under its contract with the federal government. Based on information from the Department of Energy (which operates most of the GOCO laboratories), CBO assumes that the Ames Laboratory is the only facility that is expected to return income to the federal government over the next five to ten years. CBO estimates that reducing the percentage of income that is returned to the Treasury would increase direct spending (and would be recorded as a loss of offsetting receipts) by about \$3 million over the 2010-2014 and 2010-2019 periods. Receipts would end after 2013 when the Ames patent generating the bulk of the royalties expires.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

S. 515 would impose a mandate on both intergovernmental and private-sector entities, by allowing PTO to set or adjust certain fees and by permanently extending other fee increases that are set to expire at the end of fiscal year 2009. The requirement to pay those fees is a mandate because the federal government controls the patent and trademark systems, and no reasonable alternatives to the systems exist.

Based on information from PTO, CBO estimates that the cost to comply with the mandate would amount to less than \$1 million for public entities and between \$70 million and \$80 million for private-sector entities in each of the first five years the mandate is in effect. Therefore, the costs of the mandate would fall below the annual thresholds established in UMRA (\$69 million for intergovernmental mandates and \$139 million for private-sector mandates in 2009, adjusted annually for inflation).

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