PRIOR USER RIGHTS (RELATIVE TO PATENTS)

HEARING

BEFORE THE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY
AND JUDICIAL ADMINISTRATION

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

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PRIOR USER RIGHTS (RELATIVE TO PATENTS)

TUESDAY, SEPTEMBER 13, 1994

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTELLECTUAL PROPERTY
AND JUDICIAL ADMINISTRATION,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:20 p.m., in room 2237, Rayburn House Office Building, Hon. William J. Hughes (chairman of the subcommittee) presiding.

Present: Representatives William J. Hughes, Romano L. Mazzoli, Jack Reed, Carlos J. Moorhead, and Howard Coble.

Also present: Hayden Gregory, counsel; Jarilyn Dupont, assistant counsel; Phyllis Henderson, secretary; and Joseph Wolfe, minority counsel.

OPENING STATEMENT OF CHAIRMAN HUGHES

Mr. HUGHES. The Subcommittee on Intellectual Property and Judicial Administration will come to order.

Good afternoon and welcome to today's subcommittee hearing. Today we are hearing testimony on an issue that has significant implications for patent owners and American industry. Prior user rights is not a new issue, having been previously considered by the subcommittee during the 102d Congress in the context of patent harmonization.

Where the patent laws of a country recognize what we call prior user rights, someone who has made and put into use an invention may continue to make and use that invention, even though that person did not obtain a patent and even though, later, someone else did patent that product or process.

Most foreign countries recognize some form of prior user rights. The United States does not, at least not directly. Because the recognition of such rights provides additional protection for domestic industry against foreign patent owners, U.S. industry is, it is argued, at a competitive disadvantage.

Under our laws, prior use does have legal consequences, but not in the sense of creating affirmative rights. Use prior to another's invention can have the effect of defeating the other person's ability to obtain a patent. However, such use must be an open and public use. U.S. inventors who have relied upon trade secret protection are finding that their inventions are being patented by foreign competitors, not only in foreign countries but in the United States as well.

Prior user rights, as evidenced by past debates, is not a simple issue nor one that lacks controversy. The arguments on both sides are compelling and deserve a full review by this committee. The review involves not just whether there should be additional protection of domestic industry but a policy debate about the scope of rights for patent owners and the potential impact on American patent owners.

The questions raised become more critical in light of the past practices of certain industries that could not obtain patent protection for its products because of the state of our law at the time. This is particularly true of the domestic software industry, one of the strongest in the world. Unable to patent, other means of protection were utilized. Whether this protection still suffices and prevents encroachment of product rights is an issue to resolve.

U.S. domestic industry should not be put at a competitive disadvantage to foreign industry. We need to review our policy to determine if our industry is not on an equal footing with foreign competitors. If it is not, we then need to determine the best policy that will address the inequity. I believe this oversight hearing will answer many of these questions and it promises to be a very interesting hearing.

The Chair recognizes the gentleman from North Carolina, the distinguished ranking Republican on this subcommittee.

Mr. COBLE. Thank you, Mr. Chairman. I have no opening statement but I would like to submit for the record the statement of Mr. Moorhead, the gentleman from California.

Mr. HUGHES. Without objection, it shall be received.

[The opening statement of Mr. Moorhead follows:]

OPENING STATEMENT OF THE HONORABLE CARLOS J. MOORHEAD ON PRIOR USER RIGHTS SEPTEMBER 13, 1994

THANK YOU MR. CHAIRMAN. I WOULD LIKE TO TAKE THIS OPPORTUNITY TO COMMEND OUR LEADOFF WITNESS THIS AFTERNOON THE COMMISSIONER OF PATENTS, FOR HIS LEADERSHIP AND THE GOOD JOB HE IS DOING IN THAT OFFICE. ALTHOUGH I BELIEVE OUR PATENT SYSTEM IS THE BEST IN THE WORLD AND IT HAS PLAYED AN IMPORTANT ROLE IN MAKING THIS COUNTRY WHAT IT IS TODAY, OUR SYSTEM IS NOT PERFECT AND WE MUST CONTINUOUSLY MAKE ADJUSTMENTS TO THIS SYSTEM IN ORDER TO KEEP ON TOP OF AN EVER CHANGING WORLD. I BELIEVE THE COMMISSIONER IS DOING THIS BY MAKING US FOCUS ON SOME NEW IDEAS THAT COULD SUBSTANTIALLY IMPROVE OUR PATENT SYSTEM. PRIOR USE RIGHTS MAY BE ONE OF THESE IDEAS.

I WOULD LIKE TO COMMEND OUR CHAIRMAN, MY GOOD FRIEND FROM NEW JERSEY FOR SCHEDULING THESE HEARINGS ON THIS IMPORTANT ISSUE EVEN THOUGH IT'S LATE IN THE SESSION. LAST CONGRESS, HE AND I INTRODUCED H.R.

4978, THE SO-CALLED "HARMONIZATION BILL", NOT BECAUSE WE WERE PROMOTING OR EVEN SUPPORTING ANY OF THE IDEAS CONTAINED THEREIN, BUT RATHER WE FELT THAT IT IS IMPORTANT TO DISCUSS AND DEBATE POSSIBLE IMPROVEMENTS IN OUR PATENT SYSTEM. I MIGHT ADD THAT THE COMMISSIONER HAS AGAIN TAKEN THE LEAD IN THIS DIFFICULT AND CONTROVERSIAL AREA AND HAS HELD HEARINGS AT DIFFERENT PLACES IN THE COUNTRY. THIS MAY BE UNPRECEDENTED AT THE PATENT OFFICE.

THE BILL THE CHAIRMAN AND I INTRODUCED LAST CONGRESS DID CONTAIN A SECTION ESTABLISHING A PRIOR USER RIGHT AND I AM LOOKING FORWARD TO HEARING TESTIMONY ON THIS ISSUE.

THANK YOU MR. CHAIRMAN.

Mr. HUGHES. The gentleman from Kentucky has left us.

Our first witness is Bruce Lehman, Assistant Secretary of Commerce and the Commissioner of Patents and Trademarks since August 1993.

Prior to his confirmation, Bruce Lehman was a partner in the law firm of Swidler & Berlin. In that capacity, he represented a number of clients in matters involving intellectual property law issues and worked closely with the subcommittee. He also served as chief counsel to this subcommittee for about 9 years.

He served as a member of the Advisory Committee on Intellectual Property at the U.S. Department of State and has been a member of the U.S. delegations to diplomatic meetings and conferences in the field of intellectual property. Mr. Lehman graduated from the University of Wisconsin in 1967 and from the University of Wisconsin School of Law in 1970.

Bruce, we welcome you here today to the subcommittee. You are no stranger to the committee. We have your written statement and without objection, it will be made a part of the record in full. We hope you will summarize, but you may proceed as you see fit. Welcome.

STATEMENT OF BRUCE A. LEHMAN, ASSISTANT SECRETARY OF COMMERCE AND COMMISSIONER OF PATENTS AND TRADEMARKS, U.S. DEPARTMENT OF COMMERCE

Mr. LEHMAN. Thank you very much, Mr. Chairman. It is always a pleasure to be back here, and I would like to shorten my statement considerably, if that is OK, and present the full statement for the record.

We are really here today to talk about a patent system that benefits American industry. That is really the purpose of it. The purpose, our purpose is to talk about equity in the patent system. And I think because of that, it is important when we are speaking of prior user rights to focus on the fact that what we are talking about is a defense to a charge of patent infringement. So a prior user right is more a defense than a right.

If asserted successfully, the prior user defense would enable a prior user to continue use of an invention despite the fact that another holds a patent covering that invention. And generally speaking a prior user defense would only be available to a party who commercializes or makes a significant effort to commercialize, but has not patented the invention that is independently developed and subsequently patented by another.

And it is important to understand what we are dealing with here is a situation where you have come up with the technology yourself, have not filed for a patent, and then someone later comes up with the same thing and then patents the invention. Under the legislation we are talking about today, you would have a defense against infringement from that party.

Success in today's highly competitive manufacturing industries depend, to a large degree, on not simply whether but how one produces products. And so informal innovations are developed and implemented on the factory floor all of the time that can play a significant role in determining the success of an individual business. In today's competitive world, this is happening every day on the factory shop floor, and these informal innovations are often relatively simple incremental improvements of existing products or processes. For example, slightly changed reactions in a chemical manufacturing process.

Despite their stature, these advances oftentimes can provide a company with an identifiable commercial advantage over competitors and when this happens this presents a dilemma for companies that manufacture products in the United States, particularly small- and medium-sized manufacturers that do not have big staffs of lawyers to help them out.

It is simply not feasible for those companies to patent every single innovation as it comes along. Keeping in mind that sometimes this is a question of whether an innovation is patentable in the first place. This can require a 100-page legal brief. And a lot of our small businesses and medium-sized companies just do not have those resources.

So in many cases a company may be uncertain as to whether the invention will meet the statutory requirements of patentability. And even if they decided to spend a lot of money, they may conclude as a matter of business judgment that it is not, the patent is not a cost-effective mechanism for protecting this particular innovation or this particular invention, particularly where, as is common for informal inventions in the area of manufacturing processes, it can be difficult to discover and prove infringement.

Any of these considerations can lead a company to quite a reasonable and commercially sound decision not to seek patent protection on a particular invention, and yet such a decision under our current patent system can expose that company to a significant risk if the invention is later developed and patented by another person. Remember, later developed and patented by another person.

Our patent laws were not designed to force American companies to seek patent protection for every invention that they develop, and that is an important point for us to focus on. You know, the purpose of the patent system, in fact, is not even necessarily to promote patenting, it is to promote progress in the science and useful arts. It is to stimulate innovation. So if that innovation can be stimulated or is stimulated even without patenting, we are still successful. We have still achieved our purpose and in some cases it might even be better rather than having to siphon off valuable resources to legal costs and other things.

So the patent system is really one facet of a larger system that is designed to encourage not only technological innovation but also the realization of the benefits of innovation, which ultimately are new products and services delivered into our marketplace.

In many cases the commercially sound strategy for a manufacturer is to forgo patent protection, and then perhaps rely on trade secrecy to protect the invention. This, however, opens the door to a later inventor who may independently develop and patent the invention, who maybe made a different decision about patenting. This can have serious consequences for the party that opted out of the patent system.

We have concluded, after studying this bill, that the larger goal of realizing the benefits of innovation and encouraging people to make that constant innovation on the factory floor without running up to the General Counsel's Office every 5 minutes is best served by policies that provide American companies with maximum flexibility in developing commercially sound strategies for managing innovation.

There really are three good reasons for this prior user defense, and I would just like to summarize those and then open myself up to questions, if it is OK with you, Mr. Chairman.

The first is that the prior user defense will help parties more fairly and efficiently resolve disputes that can arise when one party uses an innovation that is later patented by another. Successful assertion of a prior user defense will not invalidate the patent and can be based on a more objective evidentiary showing than is needed to invalidate a patent under the current law because of prior invention.

Second, a prior user defense will eliminate the disparate treatment of American and foreign manufacturers that you referred to in your opening statement.

And, finally, a prior user defense could help resolve concerns that have been expressed in the software industry, which you also referred to in your opening statement, regarding prior use of poorly documented techniques that are later patented by another. And this particular subject matter is one that, when it was first presented to me, I have to tell you, I had some questions about, but the more I thought about it, the more I realized that there was great merit in this proposal.

One of the things that helped me in making that decision was that we have tried to be innovative in our own Office. We have been going out and having extensive hearings and talking to members of the public, people that use our Office, because we do not have to be guided by the bells and business on the House floor, of course. We can sit there all day and we do not have to limit the number of witnesses. And so anybody that wants to come and talk to us can. A little like the city councils or State legislatures, where you sort of sit there all night.

And we have done that. We have had extensive hearings in a number of different industries and one was in the software industry. We went out to California, and over and over again we heard this refrain, that people in the software industry do not want to have to, "call up legal before they can enter key strokes on to their computer." And a lot of that concern was driven by the fact that there just might be some patent out there or that somehow or other is going to come bite them in the rear.

And, really, that is what the prior user defense is all about. It enables people to engage in their business and if they make a decision not to patent, and then later on some independent inventor comes along, and we are generally not going to be speaking about the breakthrough inventions or anything like that, at least they have a right to continue to use that technology.

Now, that right is not going to be able to be transferable to somebody else, unless of course you transfer the assets of the whole company. But at least they are not going to be tied down by extensive litigation. That innovative process that occurs on a day-to-day basis is not going to be chilled by legal, as we were told that it sometimes is, when we were out in California. And I think that the innovative process in America is going to be better off for it.

And keep in mind that the purpose of the patent system is really so that people can get a patent document from our Office that they can take to the bank to get financing, to get stock equity, and so on that is going to enable them to do business.

Sometimes for particularly minor inventions it is not necessary to go through all of that. You do not need that incentive. And so if the patent system is too hard on these people and too strict you may actually have the effect of depressing innovation rather than encouraging this kind of incremental innovation on the line, on the factory floor that really the patent system is all about.

So that briefly summarizes, Mr. Chairman, why we have come to the conclusion that we recommend the enactment of prior user legislation.

Mr. HUGHES. Thank you, Bruce.

[The prepared statement of Mr. Lehman follows:]

STATEMENT OF BRUCE A. LEHMAN
ASSISTANT SECRETARY OF COMMERCE
AND
COMMISSIONER OF PATENTS AND TRADEMARKS
BEFORE THE
SUBCOMMITTEE ON INTELLECTUAL PROPERTY
AND JUDICIAL ADMINISTRATION
OF THE
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 13, 1994

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear today to testify in support of the concept of prior user rights. Let me begin by noting that "prior user rights" is not a wholly accurate phrase. What we are really speaking of when we refer to a prior user right is a defense to a charge of patent infringement. If asserted successfully, the "prior use" defense would enable a prior user to continue to use an invention despite the fact that another holds a patent covering that invention. And, generally speaking, a prior use defense would be available only to a party who commercializes or makes a significant effort to commercialize, but does not patent, an invention that is independently developed and subsequently patented by another.

Success in today's highly competitive manufacturing industries depends to a large degree on not simply whether, but how one produces one's products. "Informal" innovations developed and implemented on the factory floor can play a significant role in determining this success. These informal innovations are often relatively simple, incremental improvements of existing products or processes -- for example, slightly changed reaction conditions in a chemical manufacturing process. Despite their stature, these advances can provide a company with an identifiable commercial advantage over its competitors.

This presents a dilemma for companies that manufacture products in the United States -- it simply is not feasible for a company to patent every invention it may develop. In many cases, the company may be uncertain whether the invention will meet the statutory requirements of patentability. Patent applications also require a not insignificant cost, measured both in time and in money. And once obtained, a patent may not prove to be a cost-effective mechanism for protecting an invention, particularly where, as is common for informal inventions in the area of manufacturing processes, it can be difficult to discover and prove infringement. Any of these considerations could lead a company to a quite reasonable and commercially sound decision to not seek patent protection on a particular invention. Yet, such a decision in our current patent system can expose the company to a significant risk if the invention is later developed and patented by another.

Our patent laws were not designed to force American companies to seek patent protection for every invention they develop. Rather, they are one facet of a larger system designed to encourage not only technological innovation but also realization of the benefits of innovation -- new products and services delivered into the marketplace. In many cases, the most commercially sound strategy for a manufacturer to pursue is to forego patent protection and perhaps rely on trade secrecy to protect an invention. This, however, opens the door to a later inventor independently developing and patenting the invention, and with that, serious consequences for the party that has opted out of the patent system.

The larger societal goal of realizing the benefits of innovation is best served by policies that provide American companies with the maximum flexibility in developing commercially sound strategies for managing innovation. We believe an appropriately limited prior user right would further this goal. The availability of a prior user right would mitigate the pressure and confusion that entities currently face in deciding whether to seek patents on relatively minor inventions by providing the best array of options for a company to protect its innnovation. A prior user right would also help preserve the important balance between our patent and trade secret systems by lessening the significant risks that ~~can~~ accompany a choice of not using the patent system to protect an invention. In this regard, it is important to remember that trade secrecy complements, rather than conflicts with, our patent system. As the Supreme Court explained in Kewanee Oil Co. v. Bicron Corp, 416 U.S. 470, 94 S.Ct. 1879, 40 L.Ed. 2d 315, 181 U.S.P.Q. 673 (1974),

> [t]rade secret law and patent law have co-existed in this country for over one hundred years. Each has its particular role to play, and the operation of one does not take away from the need for the other. Trade secret law encourages the development and exploitation of those items of lesser or different invention than might be accorded protection under the patent laws, but which items still have an important part to play in the technological and scientific advancement of the Nation. Trade secret law promotes the sharing of knowledge, and the efficient operation of industry; it permits the individual inventor to reap the rewards of his labor by contracting with a company large enough to develop and exploit it.

We also believe that for the vast majority of clearly significant, patentable inventions, the availability of a prior user defense will have little, if any, influence on an inventor's decision between patent and trade secrecy. For such inventions, the decision will continue to be dictated by the characteristics, effectiveness and suitability of each form of protection vis-a-vis the invention. Prior user rights are likely to play a role in this decision only for those inventions which can be effectively protected through trade secrecy or for which protection is unnecessary, and for which it is not clear that meaningful patent protection can be obtained. Prior user rights thus will permit companies to choose with confidence not only the most effective legal means for protecting their technological innovation, but also the most commercially sound approach to commercially exploiting the innovation.

We believe there are other benefits of an appropriately limited prior user right.

First, the availability of a prior use defense could more efficiently and fairly resolve disputes between a patent owner and a prior user of an invention. Today, under 35 U.S.C. 102(g), if a prior inventor does not conceal, suppress or abandon an invention, evidence of this prior invention can be introduced in court to invalidate a patent. But it is unclear under current law when maintaining some aspects of an invention in secrecy will amount to concealment or suppression. For example, in Dunlop Holdings v. Ram Golf Corp., 524 F.2d 33; 188 U.S.P.Q. 481 (7th Cir. 1975), the Seventh Circuit addressed a situation where a prior user concealed manufacturing details of a product as a trade secret but nevertheless asserted that public availability of the product of that manufacturing process should be viewed as a sufficient basis for invalidating the patent under 35 U.S.C. §102(g). The court agreed, explaining:

> [t]here are three reasons why it is appropriate to conclude that a public use of an invention forecloses a finding of suppression or concealment even though the use does not disclose the discovery. First, even such a use gives the public the benefit of the invention. If the new idea is permitted to have its impact in the marketplace, and thus to "promote the progress of science and useful arts," it surely has not been suppressed in an economic

sense. Second, even though there may be no explicit disclosure of the inventive concept, when the article itself is freely accessible to the public at large, it is fair to presume that its secret will be uncovered by potential competitors long before the time when a patent would have expired if the inventor had made a timely application and disclosure to the Patent Office. Third, the inventor is under no duty to apply for a patent; he is free to contribute his idea to the public, either voluntarily by an express disclosure, or involuntarily by a noninforming public use. In either case, although he may forfeit his entitlement to monopoly protection, it would be unjust to hold that such an election should impair his right to continue diligent efforts to market the product of his own invention.

See also, E.I. Du Pont De Nemours & Co. v. Phillips Petroleum Co., 849 F.2d 1430, 7 U.S.P.Q.2d 1129 (Fed.Cir. 1988); International Glass Co. v. United States, 408 F.2d 395, 159 U.S.P.Q. 434 (Ct.Cl. 1969).

Providing a prior user right could help remove the uncertainty that exists today, particularly with respect to evidentiary proofs in such circumstances. For example, instead of assessing the subjective question of whether an inventor suppressed or concealed an invention, determinations of prior use would be based on the objective criteria of the nature and amount of use of the invention by the prior user. These objective criteria will help parties accurately predict the implications of prior use, which, in turn, will not only simplify litigation, but could also help patent owners and prior users determine their respective rights out of court. Measures which reduce uncertainty in the law and encourage settlements between potential litigants should be strongly supported.

The availability of prior user rights would also resolve conflicts involving prior invention in a manner that is less detrimental to the patent owner's interests than is possible today. Under current law, a prior user that is sued for patent infringement will likely assert as a defense that the patent is invalid under 35 U.S.C. § 102(g). And the outcome of that effort will be far from clear. In contrast, if a prior use defense were available, a legitimate prior user would be likely to assert a prior use defense, rather than attempt the more difficult and unpredictable effort of invalidating the patent under 35 U.S.C. § 102(g). If successfully asserted, the prior use defense would alter neither the validity nor the character of patent rights held by a subsequent inventor, except in relation to the prior user. The patent owner would be able to enforce its rights fully against all others that make, use or sell the patented invention without authority.

Prior user rights would also redress a current imbalance of rights between U.S. and foreign businesses. Prior user rights are available in most foreign, industrialized nations. This means that in those countries, U.S. businesses that hold patents cannot enforce their rights against companies that can demonstrate prior use of the patented invention. The converse, however, is not true. A domestic prior user has no effective defense based on secret prior use when facing a threat by a foreign company that obtains a U.S. patent covering the invention. Recall that presently over 44% of all patents issued in the United States are issued to foreign entities. Providing a prior user right will address this disparate treatment of U.S. businesses.

Prior user rights may also help in addressing concerns that have been expressed in the software industry. Recently, the Patent and Trademark Office (PTO) held hearings and solicited public input on the use of the patent system to protect software-related inventions. We heard from a wide range of interests, including small and large software companies, independent software developers, patent attorneys and trade associations. Several companies, particularly small software start-up firms from Silicon Valley, expressed concerns over potential liability for patent infringement based on their use of "old" or "well known" software techniques. These individuals believe that patents have been granted that cover such techniques, in part because the techniques were not documented in patents or printed publications. The proposed prior use defense could address one aspect of the problem these companies have described. It would enable a company that had made the requisite degree of commercial use of the "old" technique under the appropriate circumstances to avoid liability for patent infringement. It would provide this relief without requiring the company to prove that the patent being asserted against them is invalid. Importantly, the type of evidence that could be used to establish a successful prior use defense could encompass forms of evidence that do not fit cleanly within our current definitions of prior art. And while we are unsure as to how frequently this scenario may arise, we believe the legislation would address the concerns as they have described.

Our support for the concept of prior user rights has been aided by the fairly extensive discussions of this topic that have taken place over the past thirty years During the 1960s, particularly after President Johnson's 1968 Presidential Commission on the Patent System, prior user rights were extensively debated. These debates were framed much as today by the prospects of legislation that would introduce significant changes to our patent system, including a change that would convert our "first-to-invent" system for determining priority to a first-to-file system. Since then, prior user rights has remained to a varying degree as a lingering, yet controversial, question. And in recent years we have seen the prior user rights issue manifest itself in several forms. Many have proposed creation of a prior user right as an essential component of a restructured domestic patent system which includes a first-to-file system for determining priority of invention. However, not all discussion of prior user rights takes place in this context. And, earlier this year, Senator DeConcini introduced S.2341 which would create a prior user right in our current "first-to-invent" system.

To help frame the prior user rights discussion, I would like to recount our recent considerations of prior user rights, and offer our views on legislation pending in the Senate that would create a prior user right.

The Advisory Commission on Patent Law Reform

During 1991 and 1992, an Advisory Commission established by then Secretary of Commerce Robert Mosbacher studied the question of adoption of a first-to-file system as part of a patent law harmonization treaty. A significant amount of time was spent by this group discussing the question of prior user rights. After much deliberation, the Commission voted in favor of including a prior user right as part of a U.S. first-to-file system. However, the vote on this issue was very close, and its result caused one member to withdraw from the Commission.

As proposed by the Advisory Commission, the prior user right would have the following characteristics.

- It could only be based upon activity within the United States prior to the earliest filing date to which the relevant claim or claims of the patent were entitled, including a foreign priority date under 35 U.S.C. § 119.

- It could only be claimed for inventions that were independently developed by the entity claiming prior use, without derivation from the patentee, and produced in good faith. The Commission noted that "[t]he key to this concept of independent creation is that the prior user should not be able to take advantage of the patentee's pre-filing disclosures to create the right which will subsequently be used to avoid liability under the later-issued patent."

It could only be based upon actual use in commerce of the patented invention, or substantial and material preparations for such commercial use. The Commission considered preparations for commercial use to "substantial and material" if they "represent activity toward actual commercialization as opposed to mere plans or preliminary efforts toward subsequent activity." The Commission would have also required, at a minimum, that the prior user "completed an actual reduction to practice of the invention for which the right is claimed, prior to the patentee's earliest filing date, to claim the prior user right defense." It also recited a number of factors to consider in determining whether there had been a sufficient level of use by the prior user. These included the costs incurred by the prior user in developing the invention, the amount of time spent in preparation for commercial use, the complexity of such preparations and the diligence of the prior user toward use of the invention.

It could only be transferred with that part of a business which exploits the right. As the Commission stated, "[t]his is essential to preserve the personal nature of the prior user right, and to prevent [it] from being extended to resemble a compulsory license-like authority to avoid liability for patent infringement that can be transferred or licensed to others."

The prior user would have the burden of proof in establishing the defense.

The prior user would have been limited to continuation of the particular activity which gave rise to the right. The prior user would not have, for example, been able to claim the defense to permit use of improvements of the invention that would infringe other claims of the patent. However, the Commission believed that a prior user should have been permitted to expand the scale of use of the invention to "meet reasonable market demands within the United States, rather than being restricted to only the pre-filing volume of use." It also suggested that the prior user not be restricted geographically within the United States.

- The right would have had an equitable nature, meaning that a court in appropriate cases could order the prior user to pay compensation for continued use of the patented invention.

The Commission discussed but ultimately opposed inclusion of other characteristics of a prior user right that were offered to address concerns identified by non-manufacturing patent owners. These concerns were based on the belief that the availability of prior user rights would cast a cloud over patent rights, particularly regarding enforcement, and would thus significantly lessen their licensing potential.

One proposal would have restricted the availability of the prior use defense to preclude its use in relation to patents held by non-manufacturing entities. An alternative to this first proposal was creation of administrative tribunal to which prior users would register and adjudicate prior use claims. The Commission declined to adopt these special treatment provisions for non-manufacturing entities. It stated a blanket exclusion for non-manufacturing patent owners was overbroad and could have the effect of chilling university-industry collaboration. It viewed the administrative tribunal proposal as unworkable. As it stated, the latter proposal "would require a voluntary admission of liability for infringement, and if no prior user right is established, the entity would be unfairly prejudiced in a subsequent judicial proceeding."

Another proposal would have limited the grounds upon which a prior use defense could be based. It would have precluded a prior user from asserting the right if the prior user intentionally concealed his or her prior use. The rationale offered to support this proposal was that it would be unfair to reward an inventor who intentionally conceals, rather than seeking protection through the patent system, for an invention. The Commission however, rejected this limitation, stating that it "could create, in effect, a 'compulsory patenting' system, forcing the disclosure of trade secrets. " The Commission expressed concern over a distinction between intentional and unintentional concealment, and suggested that imposing such a requirement would unduly complicate litigation over assertion of the defense.

The Patent System Harmonization Act of 1992

The second prior user rights proposal I would like to discuss was that proposed by the Chairman and his counterpart in the Senate, Senator DeConcini, in the 102nd Congress in the companion bills, H.R. 4978 and S. 2605. That legislation would have created a prior user right as part of a U.S. first-to-file patent system. The elements of the prior user right as found in those bills can be summarized as follows.

- The right was structured as an exception to the definition of patent infringement. It would have provided that a person would not be liable as an infringer under a patent granted to another if he or she had, "acting in good faith, commercially used or commercially sold in the United States" or "made effective and serious preparation therefor in the United States" before the effective filing date of the application giving rise to the patent.

- The right were "personal" and would not have been transferable except in connection with assignment or transfer of the entire business or enterprise to which the rights relate.

- A prior user would be deemed to have acted in good faith if he or she had not derived the invention from the patentee.

The legislation did not address such issues as which par·y had the burden of proof or expansion or alteration in the level of use of the patented invention by the prior user.

In April of 1992, this Subcommittee, in conjunction with the Senate Subcommittee on Patents, Copyrights and Trademarks, held joint hearings on these bills. The hearings drew wide attention to the question of patent law harmonization, with particular attention on the questions of change to a first-to-file system of priority and prior user rights. We note that the previous Administration expressed its support for the legislation, including the provisions that would have created prior user rights.

S.2272 - The Patent Prior User Rights Act of 1994

The most current proposal on prior user rights is found in S.2272, the Patent Prior User Rights Act of 1994, introduced by Senator DeConcini earlier this year. This bill proposes to establish a prior user right in our existing "first-to-invent" system. Senator DeConcini's proposal includes aspects from several earlier prior user right proposals.

- The prior use defense would be available only to those parties that had made actual commercial use of a particular invention, or had made "effective and serious" preparation for use of the subsequently patented invention. A prior use defense could not be based, for example, on activities amounting only to preliminary research or investigation.

- A party seeking to rely on the prior use defense quite appropriately must demonstrate that the conditions necessary to establish the defense exist.

- The prior use defense would not be available if the activity upon which the defense is asserted was based on information derived from the patent owner or parties in privity with the patent owner. Similarly, one could not assert a prior user right if the activity in question had been abandoned on or after the earliest effective filing date of the patent subsequently obtained by the later inventor.

- The right of a prior user to continue use of the patented invention would be effectively but fairly limited. Under proposed §273(c), rights provided to a prior user extend only to those aspects of the patented invention that the prior user was in possession of prior to the earliest effective filing date of the application leading to the patent. The bill also takes into account commercial realities by permitting the prior user to "make and use variations and improvements" of the patented invention. This, for example, would permit a prior user to increase in a reasonable manner his volume of use of the patented invention. However, these variations in use of the protected invention cannot rise to the level of infringing additional claims of the patent. And proposed §273(e)(3) reiterates that the prior user right is not a general license under the patent.

- The right would be personal to the prior user and could not be assigned, licensed or transferred independent of transfer or sale of the entire business or enterprise that had engaged in the activity giving rise to the prior user right. This provision will preclude prior users from converting the defensive character of the right into a freestanding transferable license to practice the patented invention.

We believe the restrictions on the availability and character of the prior use defense as proposed by Senator DeConcini strike the proper balance between the rights of a patent owner and the rights of an earlier innovator who elected not to seek a patent, but to instead use trade secrecy to protect an invention.

I thank the Chairman for the opportunity to express the views of the Administration, and would be pleased to answer any questions.

Mr. HUGHES. Let me just first state that I came at the issue on prior user rights almost the same way you did because of my concern that it would perhaps be rewarding those that should have secured a patent and the impact it would have on the patent process. But the more I thought about it, like you, the more I realized that there are a lot of things you would not want to necessarily encourage them to secure a patent for, innovations of the work at the work station, for instance. A good example.

Can we define what basically should be protected by prior use and what should somebody who has innovated secure by way of a patent?

Mr. LEHMAN. Well, I think that the legislation that has been crafted, which is pending in the Senate—I am not sure the bill is actually here yet—does that quite well, frankly. It is a very limited prior user right, and I think it should be limited. And, obviously, it is limited to situations in which the right only—obviously is available to the first user. In other words, it is only available to assert against subsequent inventors. The right is not transferable, unless you sell the whole business. And I think those are the kinds of limitations that make certain that this defense is not going to be abused.

Mr. HUGHES. Should it be transferable to the patentee?

Mr. LEHMAN. Well, the legislation, I believe, does not provide for it to be transferred to anybody, and it does not really need to be because the patentee already has that right.

Remember, I said we should have styled it a prior user defense to start out with because it is really a defense. So who is your defense against? It is against the patentee and the patentee does not need you to transfer the right to him.

Mr. HUGHES. The debate on prior user rights has always been in conjunction with the first-to-file system instead of with our present patent system of first-to-invent. Do you believe there would be major differences in the operation of prior user rights between these two systems?

Mr. LEHMAN. Well, I think that the case for prior user rights is considerably stronger in a first-to-file system than it is even in ours, and that is because in a first-to-file system, of course, you may have situations in which the first inventor has not won the race to the Patent Office. And of course you know that is very troubling to a lot of people.

And one of the protections that prior user rights offers in that situation is that if you have not won that race, at least you will not be put out of business. You will be able to use the technology that you invented. It is because that race to the Patent Office is something that is troubling to us that this administration has not yet determined to support a change to a first-to-file system.

But the legislation that we are talking about here has merit even in the first-to-invent system that we have, and I think I described that pretty much in my opening statement. There clearly are situations, even in a first-to-invent system, where a first inventor, for having legitimate reasons, does not necessarily want to incur the expense and go through all the rigmarole of actually filing a patent and getting that patent protection, and he should not have to then subsequently, you know, try to knock out somebody's patent in a patent infringement case and spend a million dollars' worth of legal fees in order to keep on doing what he wants to do if he does not have to.

Mr. HUGHES. Did the 1968 Presidential Commission on Patent Systems support prior user rights with the use of trade secrets?

Mr. LEHMAN. The prior user rights were not a part of the 1968 recommendations. They only came along later on in the Advisory Commission during the Bush administration.

Mr. HUGHES. Does the administration support the Advisory Commission's proposal which would permit a court to award appropriate and reasonable royalties to a patentee under a prior user rights scheme?

Mr. LEHMAN. The legislation that is pending does not provide for that, and that is, I think, because of the philosophy behind that, which I think is sound, which is to try to make this as uncontroversial as possible and so it has a negative effect on as few people as possible.

However, I would say that there is some merit—there could be some merit to the idea of reasonable royalties, particularly in the case of I think one that you will hear testimony I think from an educational group. Historically, university innovators have been somewhat cool to the idea of prior user rights because, obviously, the situation I have described does not apply to them. They are not—they do not have a factory floor where innovations are taking place. All they have is basic technology and all they are in the business of is developing it and licensing it. So prior user rights do not mean very much to them.

Clearly, if you had a royalty, that would provide some advantage to those kinds of users. But I think you would have to, again, consider that, weigh that very carefully to make certain that you are not trying to bite off more than we are trying to do here. I think I have outlined pretty well why we think this is a good idea. It is to do equity to this prior user.

Every day, in a rapidly changing innovative marketplace, in high-tech industries, inventions, innovations take place that may not necessarily be worth going to the Patent Office with, and different companies have different thresholds of where they make that decision. And small businesses and medium-sized businesses, obviously, have a harder time spending the money to protect their innovations, and yet that is precisely where I think most of us feel most of the innovation and most of the competitiveness comes from.

So that is really our goal, and I think it is very important to keep this legislation as simple as we can, but I think that there is some merit, there could be some merit to the idea of royalties under certain situations, particularly where you are dealing with not-for-profit groups. And by the way, I should say this legislation has been sufficiently narrowly crafted and we checked into this before we took our position, that the association, University of Technology Managers, has decided not to oppose it.

Mr. HUGHES. Thank you.

Gentleman from North Carolina.

Mr. COBLE. Thank you, Mr. Chairman.

Commissioner, good to have you with us again, as always. As you know, Commissioner, there is a Senate bill floating around some-where, and Mr. Chairman, so far as I know there is no comparable House bill, and, therefore, as a practical matter this train probably will not leave the station this session, but I do think that the attention that we are focusing on it today and in the waning days of this session may well serve us well next session.

Commissioner, let me ask you four or five questions, if I may. I have no idea what percentage, but I am confident that the great majority of industrialized countries protect its national industry by including a prior user right in its patent system. Not having a prior user right, it seems to me, could very readily extend unfair advantages to foreign competitors as opposed to U.S. or domestic industries. Why has it taken us so long in this country to request this right?

Mr. LEHMAN. Well, actually, I am not sure it has taken us that long, Mr. Coble, in that in the last administration there was an Advisory Commission, as I mentioned, and it made a lot of recommendations to change the patent system, and this was one of them. It was a slightly different prior user right.

We have taken a look at their recommendations, and, as I think is our right and responsibility, modified them, made a number of changes. We have gone and reached out to the public, had public hearings, tried to bring more people into the process, but many of the ideas in that Advisory Commission, much had merit, and we have now adopted a lot of them in our legislative policies, some of which are pending in this committee. And this is one of those ideas that I think does have merit.

So I think that I would respectfully disagree that it has taken that long, and oftentimes, despite the vast gulf between the political parties sometimes we can agree on things.

Mr. COBLE. Permit me to amend my question then, Commissioner. Strike the fact that it has been an excessively long time. That may not be right. Why do you think our trading partners and our trading competitors abroad are ahead of us on this?

Mr. LEHMAN. The reason they are ahead of us on it is they have the first-to-file system. And as I described to Mr. Hughes a few minutes ago, I think there is a stronger need for prior user rights in a first-to-file system than there is in our first-to-invent system.

Because there, if you are not the first party to get to the Patent Office, even though you invented first, you would be just dead. You would literally be able to be sued for infringement successfully for something that was really your invention in the absence of a prior user right.

Now, under our system, since we have a first-to-invent system, if you wanted to go through the whole rigmarole, the full-blown patent infringement case, as a defendant, you might be able to prove that you were first to invent and, therefore, immunize yourself. But that is a, for a small company, that is a lot of money.

And I have been going around camping out a lot with members of the intellectual property bar, and I certainly do not even remotely wish them the opportunity to make a very fine living, but what most of them tell me is that you cannot even—when you talk about a patent infringement case—in fact, I know this because a couple of times I mentioned, well, you are spending $100,000 in a patent infringement. And they all look at me like I am crazy. That is just peanuts. The typical patent infringement case is, say, a million dollars or more a case. And what small businesses can incur those kinds of costs?

Keep in mind that one of the problems that we have here, one of the reasons that this legislation is before us, is because some, some companies from some of our trading partner countries, who have started to go after, who are in the business oftentimes of patenting incremental technology, more so than we do here, have started to go after some of our small, medium-sized companies. So if you are a small $5 million a year company and Mitsubishi sues you in Federal district court, do you, as a practical matter, have a chance to really successfully defend your prior use right in that context? I think not. And that is why there is a need for this legislation?

Mr. COBLE. In your statement, you quote *Kewanee Oil Co.* v. *Bicron Corp.*, indicating the corporation's language that trade secret law promotes the sharing of knowledge.

Now, I realize the primary purpose of our patent law—strike that. I know that is the primary purpose of the patent law, but how does keeping everything you do secret promote the sharing of knowledge?

Mr. LEHMAN. Well——

Mr. COBLE. Or am I playing too strictly on semantics here? Maybe I don't understand.

Mr. LEHMAN. No, I don't think you are. You have identified precisely the reason I think why Mr. Hughes had a problem when he first heard about this legislation and why I had a little bit of an uphill battle before I finally realized its full merits, and that is we want to be very careful to use the patent system in appropriate cases for two reasons. One is that will give them patents they can take to the bank and they can get the proper financing to really make a good business of what they are doing, employing people, creating jobs, but also because the patent system does result in very significant disclosure of the technology.

But the *Kewanee Oil* v. *Bicron* case you just referred to makes it very clear that trade secrecy is also a very important and legitimate part of the quiver of legal arrows that a business has to protect itself and that it is not inconsistent with those objectives I just described about the patent system. And I think the Supreme Court does a very good job of explaining that in that case, so I don't really want to go through it all right here, other than to say I think there clearly is a legitimate place for trade secrets.

And keep in mind we are talking about here—what we are almost talking about here is something that starts out as a trade secret and then becomes not a trade secret anymore. And at least that individual, and oftentimes with these kinds of innovations we are talking about things where it may not even be thought of as a trade secret. If you are a foreman on the factory floor and you make an innovation, and you have not thought to call the legal department because your company does not have one, and they have to call an outside lawyer and they have to bill it $350 an hour, you may have made this adjustment or this change on the factory floor, and granted you have not told anybody outside the company—maybe you or one or two engineers know it—so it literally is a trade secret, but should you have to consult with Kewanee Oil and Bicron and make a big analysis of this in order to decide where you stand? I think not. And that is really the kind of situation. That is the kind of trade secret that we are talking about here.

Obviously, companies, for example pharmaceutical companies, often might make use of trade secrecy before they decide to go public and publish an article. But that is a very highly thought out decision, and the Supreme Court tells us even that is OK. So if that is OK, I don't think we have a problem with this kind of trade secrecy that we are talking about here.

Mr. COBLE. Thank you, Commissioner. Mr. Chairman, I have two or three more questions. We have a vote on. I see the gentleman from Rhode Island.

Mr. REED. I am fine.

Mr. COBLE. Well, let me ask one more, then.

Bruce, let me combine these two, if I may, Mr. Chairman.

What impact, if any, Commissioner, will prior use rights have on trade secret law?

Mr. LEHMAN. None. That is really a different body of law.

Mr. COBLE. OK. And then one final question. I think this may be a rhetorical question but I want to hear it from you.

Why would someone use trade secret law in lieu of patent law? Now, I realize, No. 1, the desire to jealously guard the secret. No. 2, to go the patent course, at some time that protection will expire.

Other than those two reasons—I assume those two reasons are valid. Other than those two, why would a person or a corporation opt for trade secret?

Mr. LEHMAN. Well, one, the major reason is cost. I think we have to recognize—this committee is really, I think, very aware and so much of the work that you do of the major problem of cost of the legal system. We are always looking to ways where we can try to reduce that burden on litigants and where we can, in effect, provide nonjudicial remedies, we try to do so. In effect, trade secrecy is the decision sometimes to sort of elect a nonjudicial remedy. You do not have to hire a lawyer to go to the Patent Office and go through all that procedure.

So using that is not inconsistent with the general policy I think we collectively, that is you and that side of the dais and this side of the dais, are pursuing for issues such as we proposed through the expanded reexamination procedure at the patent and trademark office so that people can instead of paying a million dollars in court, an infringement case can come to us and maybe spend $7,000 or $8,000 in fees and maybe another $20,000 in legal fees and get relief.

Mr. COBLE. Thank you, Commissioner. Thank you, Mr. Chairman.

Mr. HUGHES. Does the gentleman from Rhode Island have any questions?

Mr. REED. No, I do not, Mr. Chairman. Thank you.

Mr. HUGHES. I have a couple of questions.

Business Software Alliance's testimony identifies a problem with the Senate legislation that is limited to the right to make or use variations or improvements but does not cover the sale of those variations or improvements. In fact, the bill defines "commercially used" as only a use. Do you perceive a problem with those definitions?

Mr. LEHMAN. Well, our reading of this legislation, Mr. Chairman, is that if a possessor of the prior user defense or prior user right sold a product made using that defense to a member of the public, then that product, in a sense, would carry the privileged use of the product with them. That is our reading of the legislation.

Mr. HUGHES. But I can see how they would interpret that and perhaps it is something we should clarify.

Mr. LEHMAN. I think there would be no problem with clarifying that either in legislative history or in the statute.

Mr. HUGHES. The opponents of prior user rights believe that support of the concept is an admission that the patent system itself is flawed or too expensive and that it needs changes that do not involve what is perceived as a diminution of patent rights. What is your response to that observation?

Mr. LEHMAN. That the patent system is——

Mr. HUGHES. That that is an admission there is a failure in the system.

Mr. LEHMAN. Oh, I see, yes. Well, it is awfully hard to maintain a perfect system, of course. But I don't think there has been a failure of the system at all. In fact, I think it is pretty remarkable. We have the cheapest patent system in the world.

This is one of the reasons that we are ahead of a lot of our competitors. At $80,000 a crack to get through the European Patent Office and pay all your maintenance fees and have country designation for every country, there is a pretty big disincentive to an innovator in Europe. In the United States, for the entire 17-year life of the patent, it is $3,750. And you can get into the system, for a small business, for $375. And you can get a patent in an average of 19.6 months after you apply for one.

So I think that our system is working pretty well overall and it is clearly inducing innovation in America. And that is why—in fact, recently there was a report that came out by a private study group that said the United States now has the most competitive economy in the world. It has moved to number one ahead of Japan.

And, clearly, this is not just accident. A lot of it has to do with public policies. It has to do with the fact we have gotten control of the budget deficit. It has to do with the fact we are getting control of the size of the Federal Government, that we are reading about in the paper. And it has to do also with the fact that we have a pretty good intellectual property system in which this committee has largely been responsible for over the years beginning with the work that was done in the early 1980's when there was a lot of bipartisan cooperation with this committee and with the Republican administration and we put into effect a full fee funding for the patent system. Automation was also provided for.

So I think that we have a good patent system and I think we are really working on that, and you know, Mr. Chairman, that that is a task that never ends and we always as well—we are having problems getting our fees. We have FTE problems and we will keep fighting those, but the bottom line is that right now we are doing a pretty good job. And I think that we will try to continue to do well. The system is sound. There are, clearly, legal changes that can make it better and this is one of them.

Mr. HUGHES. Thank you. And, speaking of bells, there are some bells and so we thank you for your testimony. You have been very helpful to us. Your statement, the statement will be put in the record and it was excellent and we appreciate it.

Mr. LEHMAN. Thank you very much.

Mr. HUGHES. The subcommittee will stand in recess for about 10 minutes while I cast this vote.

[Recess.]

Mr. HUGHES. The subcommittee will come to order.

Our next panel consists of Robert Merges, who is a professor of law, Boston University School of Law where he has taught since 1988. He received a B.S. degree from Carnegie Melon University in 1981, his J.D. degree from Yale in 1985, and his L.L.M. from Columbia Law School in 1988. Prior to teaching law, Professor Merges practiced law in California, working primarily with technology related startup companies. You may come forward, if you would, Professor Merges.

Our second panelist is Mr. Robert Holleyman, president of the Business Software Alliance. The Business Software Alliance represents the majority of leading U.S. software companies and is primarily concerned with fighting software piracy. The alliance has worked on the strengthening of intellectual property protections for software in the intellectual arena.

Prior to joining the Business Software Alliance, Mr. Holleyman was a senior counsel for the U.S. Senate Committee on Commerce, Science, and Transportation. He also worked as the legislative director to Senator Russell Long, and received a B.A. degree from Trinity University in San Antonio, TX, and his J.D. from Louisiana State University.

Our final panelist is Mr. Bill Budinger, who is the founder and chairman and CEO of Rodel, Inc. Rodel manufactures products used in the manufacture of semiconductor chips.

Mr. Budinger is the inventor-owner of over 36 patents. He is a 1961 graduate from Notre Dame University with a B.S. in physical science. He serves on the boards of a number of corporations as well as local art and theater groups. He presently is a trustee of the Progressive Policy Institute, a member of the Delaware Business Roundtable, and the Education Improvement Commission.

I also want to personally thank Mr. Budinger for bringing this particular issue and some of his particular problems with this issue to my attention.

Welcome to the subcommittee. We have your statements, which without objection will be made a part of the record in full. I read the statements, they are excellent, and I want you to summarize, please.

Let us begin with you, Professor Merges.

STATEMENT OF ROBERT P. MERGES, PROFESSOR OF LAW, BOSTON UNIVERSITY SCHOOL OF LAW, BOSTON, MA

Mr. MERGES. Yes, thank you, Mr. Chairman.

Let me say to start, it is always a privilege to come and put in my 2 cents' worth as a citizen on these issues. The first thing I want to say is that what we are striving to do here is a thumb screw adjustment to a very important, but remote, corner of patent law. We are not taking a pipe wrench to the system and cranking on it.

I think in this area we see the tension between trade secrets and patents very clearly. It is important to keep in mind that the two have always coexisted in our system of intellectual property rights and what we are about today is adjusting the boundary a little bit. We are not redrawing the boundary in any significant way.

The second point I am going to make is that the prior user right must be limited if it is to serve its intended purpose and if it is not to undermine patent rights too greatly.

And the third point I want to make is that on principle, the prior user right makes a lot of sense for several reasons.

On the trade secret patent interface issue, which I mentioned first, it is important to realize patents are only one instrument that businesses use to protect their R&D investments. In fact, in many industries, trade secrets are the most important instrument that industry uses. In other industries, as we know, particularly pharmaceuticals, patents are by far the most important. The point is that both exist together in a system of rights, and although the patent system has traditionally tried to encourage trade secret holders to come forth and disclose their technology, we obviously have not carried that policy rationale through totally, in the sense that it is not the only goal of our patent system.

Disclosure is important but it is not the only goal. And the reason, of course, is that we recognize that trade secret protection can be a significant impetus for the development of new technology, in addition to patents. We have always permitted the two to exist in parallel.

I think it is important to keep that in mind as we go through this discussion because we have a patent-centric view of intellectual property, since that is the Federal system and trade secret law is State law. And starting with the *Kewanee* case, the two have coexisted. We are talking about in this case adjusting the boundary to make them coexist in a better way.

I will be happy to answer questions about that.

Let me move to my second major point, which is that prior user rights must be limited to be effective. They have to be limited in two ways. First, in terms of the proof that is required to establish a prior user right, and second as to the scope of the right.

In the area of proof, I think serious efforts to commercialize and preparations to use, issues like that, have to be easy and straightforward to prove if prior user rights are to serve their intended function. I would like to see the language clarified in a number of ways. But basically, the main point is this: one of the advantages of a prior user rights system is to encourage people to rely on trade secrets, rather than in every case filing for a patent.

If it is too difficult and expensive to establish that you are a prior user, we undercut that goal of making reliance on trade secrets a viable alternative. And issues like serious efforts to commercialize, I think, are ones that need to be addressed, probably in the committee report and legislative history in general.

Let me just say as an aside, that I think that preparatory items such as: licensing and distribution, scaling up production processes, forming marketing plans, and planning to integrate a new product into product lines are generally the kinds of things that we would look for as earmarks of serious efforts to commercialize. Those are the kinds of things I think that need to be addressed. We are not quite at that level of detail in this hearing.

In terms of issues of proof, again, I think another important point is that prior user rights must be established by the defendant in a patent infringement suit, the burden of proof has to be on the person asserting that they were a prior user. They must have the burden of showing the earliest date of use. But I think they also should have the burden of showing that they did not derive the invention from the efforts of the subsequent inventor who then got a patent, which I think will go a long way toward addressing some of the issues of the university community, which I think in some cases are well-founded.

A lot of discussion in my written testimony goes to the issue of how prior user rights will actually play out in confrontations between patentees and prior trade secret holders, prior inventors. I just want to say one thing about that that I think hasn't been mentioned much, and I will leave the rest for my written comments.

I think it is imperative that the prior user right be transferable from the prior user to the patentee, which is just a straightforward proposition. If a prior user comes forward and the right is established, it ought to be a simple matter of the patentee buying out the prior user. I think it ought to be permissible and encouraged.

I think that will have the effect of really reducing the stakes in a very appropriate way in these confrontations between a prior inventor who holds a trade secret and a subsequent patentee who invented later. The reason it is important to make it transferable is that we would like to allow the subsequent patentee who wants exclusivity to buy it back for a negotiated price which will be a reasonable compensation for the investment that the prior trade secret user made in the invention, as well as for the future loss to the prior inventor's business operations from having to give up the prior user right.

And by the way, I think it is preferable to reach that compensation by private bargain than to impose some kind of reasonable royalty requirement on the two parties. The parties are perfectly well placed to bargain that out themselves, which is the normal rule in intellectual property rights, compulsory licenses being usually disfavored.

I want to say one thing on the scope of rights which is an issue that is going to have to be explored in detail if this is going to be worked out in a satisfactory way. We should have a fairly modest zone of expansion for the prior user. That is important because it will keep the prior user right from undercutting the subsequent patentee's patent rights to any great degree.

If a prior user can expand his or her use significantly after the subsequent inventor who then gets the patent comes forward, that would allow the prior trade secret user to leverage the invention which the patentee has disclosed to the public in a way that is really unfair. What we are trying to do in a sense is protect the reliance interest of the prior user, the trade secret inventor, who relied on the trade secret system and who relied, frankly, on the absence of a patent, we can assume, when they went forward and made their investment. We need to protect that, but not at too great an expense coming out of the pocket of the patentee.

My final points are issues of relatively straightforward principle. What this legislation is really all about, putting aside issues of international competitiveness and harmonization, just taking it on its own bottom for domestic industry and domestic inventors, is that it would produce a significant benefit with relatively little harm. I think that is the way we should analyze it.

The reason I say that there is relatively little harm is that where a prior user is conducting operations on a relatively low volume, given the modest zone of expansion, the prior user right is not going to affect the rights of a subsequent patentee to any great extent.

On the other hand, where a prior user is conducting extensive operations, that is a clear indication that while the subsequent patentee was the first into the patent system, the prior trade secret user was making the benefits of the advance available to the public, and therefore to the extent that that limits the patentee's rights, that is justifiable because the trade secret user was making the invention or its fruits or some aspect of it available to the public.

That is why I say there is not really much harm to the patentee in the second example. There is not much cognizable harm; the patentee was not the first to provide benefits to the public to any great degree.

In terms of the benefits, you heard from Commissioner Lehman a very important point which is that this will cut down on the incentive to file defensive patents. We think of patents as helpful from the point of view of incentive and encouraging disclosure, but I think if you cock your ear to industry's cry at this point you will hear a lot of people saying that they are rushing to the patent system for defensive purposes. It is very clear in the software industry, which is very much under discussion in this and other hearings. But I think it is a point that we have to take notice of in general.

If people are using the patent system not because it provides an incentive but as a defensive measure, as a measure that they would prefer not to take, I think we have to hear them saying "please don't give me that incentive, I don't need it. I don't want it. The only reason I am filing is because someone else might."

To revert to my earlier point, trade secrets are a viable form of protection and one that we have always encouraged. To the extent that the balance has shifted and people are rushing to the patent system for essentially the wrong reasons, I think we need to recorrect the balance and make trade secrets again a viable alternative. And they will never be a coextensive alternative, as good as the patent, for the reasons that the *Kewanee* case goes into and every commentator on this issue has gone into it.

[The prepared statement of Mr. Merges follows:]

STATEMENT

BY

ROBERT P. MERGES

PROFESSOR OF LAW
BOSTON UNIVERSITY SCHOOL OF LAW

BEFORE THE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY AND
JUDICIAL ADMINISTRATION

U.S. HOUSE OF REPRESENTATIVES

OVERSIGHT HEARINGS ON

PRIOR USER RIGHTS

Tuesday, September 13, 1994

Chairman Brooks, other members of the Subcommittee, staff members, and interested members of the public:

Thank you for the opportunity to be heard on an important issue of patent policy. It is always an honor for a private citizen to be asked to participate in the legislative process.

My written comments on prior user rights are organized as follows. First is a description of the legal background, especially the current law pertaining to prior inventors. Next is a consideration of the likely commercial impact of a prior user right. Finally, I describe what I consider the essential criteria that must be satisfied by any detailed proposal on prior user rights.

I. Legal Background

Notwithstanding the economic significance of trade secrets (see II, below), patent law has always had a curious relationship to trade secrecy, partly for federalism reasons (trade secret law is state law), and partly because one policy rationale for patents is to encourage public disclosure of technical information -- a rationale distinctly at odds with the *raison d'etre* of trade secrets. One important area of patent law where this tension has been played out is in the law of patent priority and invalidity based on prior invention, i.e., 35 U.S.C. § 102(g), which reads:

§ 102. Conditions for Patentability; Novelty and Loss of Right to Patent

A person shall be entitled to a patent unless--

* * *

(g) before the applicant's invention thereof the invention was made in this country by another who had not abandoned, suppressed, or concealed it. In determining priority of invention there shall be considered not only the respective dates of conception and reduction to practice of the invention, but also the reasonable diligence of one who was first to conceive and last to reduce to practice, from a time prior to conception by the other.

This provision sets out the basic rule of priority in U.S. law: the "first to invent" receives a patent. It also provides a defense to third parties based on prior invention; if A sues B for infringement, B can invalidate A's patent by showing that C invented first. In both types of cases the absolute first invention priority rule is subject to an important exception: prior inventions that are "abandoned, suppressed, or concealed" (for brevity, hereinafter referred to as "concealed prior inventions"). It is largely through this exception that the patent/trade secret law tension has been played out in the § 102(g) context.

Concealed prior inventions conflict with the "disclosure to the public" rationale of patents. Hence they are in general excluded from the class of inventions that can establish priority or patent invalidity; that is, they do not count as "prior inventions." *See generally* Paulik v. Rizkalla, 760 F.2d 1270, 226 U.S.P.Q. (BNA) 224 (Fed. Cir. 1985) (Friedman, J., dissenting). To the extent that concealed prior inventions are coextensive with trade secrets, then, current law disfavors trade secrecy as a form of intellectual property protection. Although several cases have held that state trade secret law may co-exist with federal patent law, *see, e.g.*, Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974), section 102(g)'s implicit "punishment" for those who elect trade secret protection shows that patent law is designed, at least in part, to encourage inventors to elect to enter the patent system.

This punishment clearly applies in the case of an invention that simply sits on a shelf for years: the classic case of concealment. Just as clearly, it does not apply where a new technology is sold to the public soon after it is perfected -- an easy case of non-concealment. There is a difficult middle ground, however, where the cases reveal uncertainty over the appropriateness of finding concealment. In these cases, a prior inventor exploits an invention, but not in a way that reveals its technical details. These cases illustrate the complexities of the patent/trade secret relationship.

Judge Learned Hand of the Second Circuit delivered an important opinion in a case like this. Gillman v. Stern, 114 F.2d 28 (2d Cir. 1940). The invention at issue was a pneumatic "puffing" machine for quilting. Only the output of the machine -- its products -- was offered for sale: the machine itself "was always kept as strictly secret as possible, consistently with its exploitation." 114 F.2d at 30. The court held that a completed invention will be deemed abandoned, suppressed, or concealed if no steps are taken to make the invention publicly known within a reasonable time. The inventor, Haas, kept his invention completely secret from the outside world, including his employees and his wife. The court held that such a secret invention did not qualify as a prior invention under the predecessor to § 102(g). *See also* Palmer v. Dudzik, 481 F.2d 1377, 178 U.S.P.Q. (BNA) 608 (C.C.P.A. 1973) (secret commercial use of yarn-making invention amounted to concealment). *Gillman* has been called a good example of a "secret" or "hidden" use case. Robbins, *The Rights of a First Inventor-Trade Secret User As Against Those of the Second Inventor-Patentee (Part I)*, 61 J. Pat. Off. Soc'y 574, 591 (1979).

Courts have reached the opposite conclusion in a related set of cases, sometimes known as "non-informing public use" cases. *See, e.g.*, Dunlop Holdings v. Ram Golf Corp., 524 F.2d 33, 188 U.S.P.Q. (BNA) 481 (7th Cir. 1975) (public sale of golf balls made with special preparation using innovative material negates finding of concealment, even though preparation and material were not discernible from the balls); Burke, *The 'Non-Informing Public Use' Concept and Its Application to Patent-Trade Secret Conflicts*, 45 Alb. L. Rev. 1060 (1981). Just because the inventor's "black box" cannot be pierced by observers, these cases hold, does not mean that the inventor is consciously concealing it. *Cf.* E.I. du Pont de Nemours & Co. v. Phillips Petroleum Co., 849 F.2d 1430 (Fed. Cir.), certiorari denied 109 S.Ct. 542 (1988) (merely because research is secret does not mean it has necessarily been "abandoned, suppressed or concealed" under § 102(g)).

Conceptually, there is not much to separate these cases from cases such as *Gillman*. The fact that only the *output* of the secret process invention was available to the public in *Gillman*, while the actual invention was sold in *Dunlop*, makes little difference. In neither case was the public informed of the technical details of the prior invention; in both cases, the public was receiving a benefit stemming from the new invention. Nevertheless, the non-informing use of *Dunlop* vs. secret (or hidden) use of *Gillman* is an accepted distinction in patent law. *See* Donald Chisum, Patents § 10.08[4] (1978 & Supp. 1994).

The upshot of this distinction is that under the current system the prior inventor who relies on trade secret protection may or may not defeat the patent rights of a subsequent inventor. Moreover, because of the complexity of these issues -- and of § 102(g) issues in general -- to rely on trade secrets in fields where others might file patents is to live with uncertainty. Arguably, one reason to favor prior user rights in such a context is to reduce this uncertainty. But there are other reasons as well, which are considered in the next section.[1]

II. The Commercial Impact of Prior User Rights

To begin, it must be understood that many industries rely heavily on trade secret protection to appropriate the value of their research and development. *See, e.g.*, Levin, Klevorick, Nelson & Winter, *Appropriating the Returns from Industrial Research and Development*, 1987 Brookings Pap. Econ. Activity 783 (1987) (reporting results of extensive empirical survey of research and development personnel at U.S. corporations; many industries value trade secrets more highly than patents as appropriability mechanism).

Trade secret protection has been important in the software industry, for example. As a consequence of §102(g) and the growing importance of patents in this industry, some commentators have shown concern that software creators who keep their software as trade secrets could wind up having to license a later inventor of the same software, or even being forced to stop using their software altogether. As the Commissioner of Patents recently testified:

> Several companies, particularly small software start-up firms from Silicon Valley, expressed concerns over potential liability for patent infringement based on their use of "old" or "well known" software techniques. These individuals believe that patents have been granted that cover such techniques, in part because the techniques were not documented in patents or printed publications. The proposed prior use defense could address one aspect of the problem these companies have described. It would enable a

[1] Indeed, it is essential to consider these other reasons, since adopting a strong *Gillman*-type view of "concealment" will eliminate uncertainty just as much as prior user rights will.

company that had made the requisite degree of commercial use of the "old" technique under the appropriate circumstances to avoid liability for patent infringement. It would provide this relief without requiring the company to prove that the patent being asserted against them is invalid. Importantly, the type of evidence that could be used to establish a successful prior use defense could encompass forms of evidence that do not fit cleanly within our current definitions of prior art. And while we are unsure as to how frequently this scenario may arise, we believe the legislation would address the concerns as they have described.

Hearings on Patent Infringement, Subcommittee on Patents Copyrights and Trademarks, U.S. Senate Committee on the Judiciary, August 9, 1994 (Testimony of Bruce Lehman, U.S. Commissioner of Patents). See Gates, *Trade Secret Software. Is it Prior Art?*, 6 **Computer Law. 11 (1989).** This is especially important because the software industry is currently undergoing a transition from being a non-patent industry to one where patents are important. (See Chapter 2 of **Robert P. Merges, Patent Law and Policy: Cases and Materials (1992)** for a discussion of these "transition costs" in the software industry.) Since many software firms have come to rely on trade secret protection, some may be hurt by the §102(g) rule. Prior user rights could afford them relief.

The same is true in other industries as well. This is important in the current environment, where patents are becoming more valuable and firms have adjusted to this fact at different speeds.

A. Litigation Settlement/Licensing Perspective

One commentator has noted that patentees may be loath to risk having their patents invalidated by bringing infringement suits against prior inventors, a risk that is presumably large in light of the uncertainty over § 102(g) "concealment" discussed in section I above. Consequently, according to this commentator, we would expect to see a settlement of any such dispute, perhaps by cross-licenses. Jorda, *The Rights of the First Inventor-Trade Secret User As Against Those of the Second Inventor-Patentee (Part II)*, 61 J. Pat. Off. Soc'y 593, 601 (1979). By this logic prior user rights might be unnecessary, since conflicts between patentees and prior inventors might be expected to result in settlements.

There is no real way of knowing whether this is true. Even if it is, however, the prior user right could be expected to change two aspects of these negotiations: (1) the relative bargaining power of the parties, and (2) the cost of the negotiation.

A prior user right would give the prior inventor a stronger bargaining position, resulting in a better outcome for him or her. This is because the prior user right gives the prior inventor a "fallback" position in the event the patentee is able to prove that the prior inventor concealed the invention, and hence that the prior invention does not invalidate the patentee's patent. The extra bargaining power conferred by a prior user right would encourage inventors to consider trade secret protection as a viable, although by no means equal, alternative to a patent.

A prior user right would affect the cost of negotiations as well, *if* the law provided objective, straightforward criteria for establishing the right. Under these circumstances, it would be much easier for negotiating parties to determine if a prior inventor qualified for a prior user right than it would be for them to determine the relevant § 102(g) issues, including whether the prior inventor had concealed the invention. Aside from this purely evidentiary advantage, prior user rights would lower the stakes in a prior inventor/subsequent inventor-patentee dispute.

Currently, the only defense available to a prior inventor who wants to continue using technology he or she developed is to invalidate the subsequent inventor's patent. Because the patent system is set up to safeguard patents from charges of invalidity, the procedural and evidentiary burdens required to establish a defense of invalidity are substantial.

A rough analogy from the world of real property comes to mind. Imagine that A has walked across a corner of B's back yard for years to reach a river. At some point, B wishes to build a fence that would block A from using this corner of B's property. Now imagine a legal rule under which A, in order to have the right to walk across that corner of the property after being challenged by B, is required to invalidate B's title to her entire plot of land.

A prior user right eliminates the need of the prior inventor to destroy the subsequent inventor's patent in order to continue her own use; it limits the stakes in the dispute to the contested "corner" of the patent right. Because of this, it can be expected to reduce the cost of bargaining to a mutually satisfactory solution. Since the vast majority of legal claims of all kinds result in settlements, this may in fact be the most important contribution of prior user rights.

B. Comparative Experience: Europe and Japan

The preceding paragraphs are meant to establish that prior user rights will not unduly harm the economic interests of patentees, yet will make trade secrets a more viable option for prior inventors. The best evidence that these rights will not have an overwhelmingly negative impact on U.S. industry is that no such impact has been documented in the many countries that have long enjoyed such rights.

Prior user rights are common in Europe and Japan. *See* Keith Kupferschmid, *Prior User*

Rights: The Inventor's Lottery Ticket, **21 Am. Intell. Prop. L. Assoc. Q.J. 213 (1993); T. Tanabe & H. Wegner, Japanese Patent Law § 841 (1984)** ("Prior Use License of Right"); Patents Act 1977 (United Kingdom), § 64 ("Right to continue use begun before priority date"). These countries generally protect the right of an independent inventor to continue using her invention despite the issuance of a valid patent covering it. Typically these prior user rights protect only inventors who begin working an invention before the other inventor files a patent application, and then only to the extent that those independent inventors continue working the invention in the same manner. Such a right, in other words, "protects only the doing of the same act of infringement as was done (or prepared for) before the priority date; allowing the user no freedom to modify or develop his activities." **1 M. Vitoria et al., Encyclopedia of United Kingdom and European Patent Law § 4-311 (1977 & Supp. 1991)**. Finally, note that the system of "prior user" rights in Europe protects the rights of first inventors/later filers in those countries. Prior inventors are allowed to continue their use of the invention after a patent issues to the second inventor. Brownlee, *Trade Secret Use of Patentable Inventions, Prior User Rights and Patent Law Harmonization*, **72 J. Pat. Trademark Off. Soc'y 523 (1990)**. *See also* European Community Patent Convention, Article 38 ("Right based on prior use and right of personal possession").

Knowledgeable observers state that the prior user right has a minimal impact on patent activities and R&D in general. *See* Lise Osterborg, *Towards a Harmonized Prior User Right Within a Common Market System*, **12 Int'l. Rev. Indus. Prop. & Copyright 447 (1981)** (in 14 years since the creation of prior user rights in England, no case reported in which it was raised as a defense; same in Italy over 13 years; 4 reported cases in the past 20 years in France);

Bardehle, *The WIPO Harmonization Treaty and the Grace Period*, **Indus. Prop., Oct. 1991, at 372**; *Franklin Pierce Law Center: Third Patent System Major Problems Conference*, **32 Idea 1, 41-64 (1991)** (discussion of need for prior user rights system in U.S.). There is simply no evidence of the negative effects attributed to prior user rights by their opponents.

III. Criteria for Effective Prior Use Right

Any prior user right should meet the following criteria:

- It must be "frozen" at the same type and level of activity that its holder was conducting when the right arose, or, at most, provide only a small "zone of expansion" in the technical features of, and volume of activity flowing from, the prior user's invention.

- Its legal requirements -- i.e., the facts that must be proven to establish the right -- ought to be as straightforward and objective as possible. This will ease the litigation burden created by a new defense, and more importantly, make private settlement negotiations cheaper and more predictable.

- It must be non-transferable to third parties, to prevent the right from undermining patentee's incentives, yet it must be explicitly transferable from its holder to a subsequent patentee.

In addition, as with most legislation, the presumption is that prior user rights should not be retroactive, so as to protect the reliance of others on the pre-existing state of the law.

A. Scope of the Prior User Right

Some prior user rights schemes that have been proposed adjust the scope of the right according to the claims of the subsequent inventor's patent. S. 2272, for instance, the prior user right bill considered by the Senate this year, limits the scope of permitted prior uses to those that infringe the claims of this patent on the date it was filed. Aside from detailed issues, such as how to handle claims that are amended after the filing date, these schemes seem to measure the wrong thing. The law should be concerned with the proper scope of the prior user rights in and of themselves, without reference to the details of the subsequent patent The limits of the prior user's rights should be defined by what her invention was on the filing date, not what the patentee claims then or subsequently. This is so because a prior user who elects trade secret protection should know with certainty what her rights will be in the event of a subsequent patent; those rights should not depend on the vagaries of the subsequent inventor's patent drafting and prosecution skills.

In my view, prior user rights must be limited if they are not to undermine the patent system. The prior user should receive some rights, but her rights ought not to detract too greatly, in the average case, from the rights of a subsequent patentee.

B. Keep it Simple (and Cheap)

For prior user rights to achieve their full potential benefit, they must present a more tractable issue for bargaining, as compared to prior invention (§ 102(g)) issues such as concealment. As mentioned earlier, making prior user rights easier to establish will make it less likely that such rights will have to be established via litigation. In this era of expanding litigation in general, and patent litigation in particular, this would be an important advantage.

For the most part the way to carry out this objective is to specify -- in legislative history, for example -- that objective evidence of use or "serious preparation" is needed to establish these rights. Lab records, corroborated by multiple researchers and backed by product development or marketing evaluations, would serve as the paradigmatic proof of prior use. Whatever the details, the clearer the criteria, the more negotiated settlements we would expect.

C. One Way Nontransferability

Prior user rights must not be transferable from their holders to third parties. They should be transferable from their holders to subsequent patentees, however.

Transferability to third parties would seriously undermine a patentee's incentives, since she could be sure that the prior user rights would wind up in the hands of her most skilled competitor. A patent in this circumstance would be no more than the right to exclude all but your most serious competition. For this reason, buying the prior user right from its holder would do the patentee no good; the holder could be expected to ask for much more than if the right were nontransferable.

Once third party transfers are prohibited, however, transfers from prior user right holders to patentees ought to be encouraged. Such a transfer would give the patentee absolutely exclusive rights, just as she receives now in the face of a holding that the prior user concealed the invention. Under a transferable prior user right regime, however, the prior user could ask for compensation for her R&D costs and the loss to her business stemming from non-practice of her invention. Of course, if she asked for too much, the subsequent patentee could decline the deal; the prior user would then be permitted to use her invention on a limited basis, as specified in the statute. The point is that by explicitly permitting transferability from prior users to subsequent patentees the law would allow absolute exclusivity, subject to some appropriate compensation (agreed to by the parties) for the loss to the prior user of her trade secret rights.

As an aside, the compensation under these deals would be a good measure of the value of the trade secret rights to the prior user. The anticipation of such compensation would then form part of the incentive to develop trade secret technologies. Again, note that this would generally be much less of an incentive than a patent, but that it would be something.

IV. Conclusion

Currently, patent law sends mixed signals to inventors regarding trade secrecy. In one sense, this is appropriate; one goal of patent law, to encourage disclosure of technology, is stymied by trade secrets. On the other hand, many inventions are of uncertain patentability, or occur in industries where firms do not generally seek patent protection.

Patent and trade secret law must therefore be made to accommodate each other. While current law achieves a workable accommodation, introducing prior user rights would alter the balance favorably. This is so because prior user rights, properly implemented, represent a significant benefit to those who choose trade secret protection, without undercutting too seriously the rights of subsequent patentees.

Mr. HUGHES. If you could conclude your testimony because I have a vote in progress. Are you completed?

Mr. MERGES. Yes.

Mr. HUGHES. I am going to take a recess for 10 minutes and I will be back.

Thank you.

[Recess.]

Mr. HUGHES. The subcommittee will come to order. And we will try it again. Mr. Holleyman, welcome.

STATEMENT OF ROBERT HOLLEYMAN, PRESIDENT, BUSINESS SOFTWARE ALLIANCE

Mr. HOLLEYMAN. Thank you, Mr. Chairman. It is a pleasure to have an opportunity to testify before your subcommittee again. Business Software Alliance represents leading publishers of software for personal commuters. On the issue of patent protection for software-related inventions, our members have divergent views.

Some companies believe that patent protection is a good thing; others believe that it is not. Some companies file for defensive purposes. BSA has previously filed a series of comments with the Assistant Secretary of Commerce and the Commissioner of Patents and Trademarks, Mr. Lehman, regarding some of the improvements that we would like to see within the context of the existing law in terms of patent protection for software-related inventions. We appreciate your interest in this matter and the issue before this subcommittee today.

Our members do agree that there would be a positive impact from the passage of legislation establishing a prior user right and that a prior user right would benefit the software industry. We believe, in particular, that it would benefit many small software companies; those companies who are least able to utilize the existing system or who find that the cost of filing software patents for defensive purposes is an expensive one.

As to the issue before us today, we would like to address a couple of comments in relation to the Senate bill, since that legislation has been introduced, and since it may be considered prior to the conclusion of this session. You posed a question to the Commissioner that addressed quite squarely the interests and the concerns of the software industry. Our concerns are essentially three: one, we believe that the bill in its current form would not necessarily provide a right to a software publisher to sell a product that encompassed a prior user right. Given the nature of our business, that is really essential to us; that the product and the commercialization of that product be protected, not simply the process that was utilized.

Second, we believe that in defining commercial use, that it is also important to recognize that the end user of the software be protected. In that context we believe that the Senate bill is overly restrictive in its use of the term "commercial use," and that term may not protect an academic user or a home user from a claim of infringement.

Finally, we believe that the Senate bill in its definition of the term of "transferability" is also unduly restrictive in that it only allows a prior user to transfer the right in the context of transfer of an entire business. In the software industry, we more commonly find that a product line or a product is transferred rather than an entire business. For the prior user right to be preserved in such a transfer, we would encourage a clarification, if the Senate bill were to be adopted, of that transferability right so it is not overly restrictive.

We believe that these three points can be addressed through a series of technical amendments to the Senate bill, which is the approach we prefer rather than relying upon legislative history. If these can be addressed, the software industry does believe that this legislation and legislation on this subject, would have value for our industry.

Absent such changes, we are concerned that the bill in its current form would have only minimal value, if any, for software. The software industry cares about this issue a great deal. Again, we have divergent opinions on the issue of patent protection overall, but we do agree on the issue of prior user rights and on some of the positive things that this committee is reviewing, and some of the positive things that Assistant Secretary Lehman is reviewing through the Patent and Trademark Office.

Thank you.

[The prepared statement of Mr. Holleyman follows:]

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STATEMENT OF
THE BUSINESS SOFTWARE ALLIANCE

Before the Subcommittee on Intellectual Property
and Judicial Administration of the House Committee on the Judiciary

September 13, 1994

Mr. Chairman:

My name is Robert Holleyman. I am the President of the Business Software Alliance. On behalf of the BSA, I would like to thank you for convening this hearing to consider the issue of prior user rights. We appreciate the opportunity to participate in this discussion.

I. <u>The Business Software Alliance.</u>

The BSA was organized in 1988 to promote the continued growth of the software industry thcugh its public policy, education and enforcement programs in the United States and more than 50 other countries throughout North America, Europe, Asia and Latin America. BSA members are actively involved in nearly all aspects of computer software development, including, for example, the production of operating systems, application programs, and networking software. Current BSA members participating in this statement include: Apple Computer, Inc., Autodesk, Inc., Intergraph Corporation, Lotus Development Corporation, Microsoft Corporation, Novell/WordPerfect Corporation and The Santa Cruz Operation, Inc.

I should clarify at the outset that members of the BSA have widely divergent views as to the value of patents being granted on software-related inventions. At the same time, in recognition of the fact that the current patent system does offer protection to such inventions, the members of the BSA appreciate the value of sharing with the Committee their views on prior user rights and the positive impact prior user rights would have on the software industry. In that spirit, the BSA would like to offer the following brief comments in support of the concept of prior user rights. As you know, Senator DeConcini has recently introduced a bill that would amend the Patent Act to provide for prior user rights. Accordingly, much of my testimony today will be directed to the provisions of the Senate bill (S. 2272).

II. General Comments.

As the BSA understands the legislation, the Senate bill would give software companies that independently develop software covered by a later-issued patent the right to continue certain activities with respect to the software after the patent issues. As we understand the intent of the legislation, end-users of such software would likewise have the right to continue to use such software after the patent issues, if they meet the prior commercial use requirement.

The BSA agrees with the thrust of the remarks made last month with respect to the Senate bill by Assistant Secretary of Commerce and Commissioner of Patents and Trademarks Bruce A. Lehman. We are gratified that Commissioner Lehman has recognized the problem faced by software firms, particularly small ones, with patents that cover software technologies which were "old" or "well-known" at the time the patents were applied for but which were not well-documented. By permitting a prior user to prove just his or her own commercial use of the technology and not the invalidity of the patent, the Senate bill would ease the burden, particularly on small start-up firms, of what otherwise might be financially crippling patent infringement suits. This is particularly so because the prior commercial use could presumably be proven by the normal evidentiary standard of a preponderance of the evidence, whereas invalidity of a patent must be proven by "clear and convincing" evidence.

The BSA also agrees with Commissioner Lehman that the Senate bill would not unduly prejudice the rights of patent owners. The prior use right is available *only* to those persons and companies which can show that (i) they commercially used the patented invention prior to the effective priority date of the application for the patent and (ii) they did not obtain the invention from the patentee or his or her privies. Moreover, the prior use right extends only to the claimed subject matter that the prior user had in his or her possession at the time the patent was applied for — it is not a general license under all the claims in a particular patent. Thus, the BSA echoes Commissioner Lehman's conclusion that the prior use right sought to be established by the Senate bill would merely strike a balance between the rights of patent owners and the rights of earlier innovators who elect trade secrecy rather than patent protection for their inventions.

All of this being said, the BSA has serious concerns as to whether the Senate bill in its current form will have the desired effects. We believe the Senate bill contains significant, albeit unintentional, shortcomings which would severely limit the practical value of the prior use right it confers, at least as to software companies and others whose primary concern is the right to continue selling a product after issuance of a patent covering technology they had previously developed and commercialized. My testimony will focus on software companies, but it should be understood that my comments are equally applicable to other "persons" whose businesses have similar attributes.

As presently drafted, the Senate bill would not clearly permit a software company, which had developed and commercialized technology covered by a newly issued patent prior to that patent's critical date, to continue marketing products containing that technology. That, to us, is a very serious problem, one which goes to the heart of our industry's concern about "software patents."

In addition, the Senate bill would not clearly permit a non-commercial *end-user* of software to continue its use in the face of a newly-issued patent, even though the *proprietor/supplier* of the software could rely on the prior use defense.

Let me explain to the Committee why the BSA interprets the Senate bill as it does.

III. <u>The Concerns of the Software Industry.</u>

Section 2(b) of the Senate bill provides that a person shall not be "liable as an infringer" of a patent if he or she had "commercially used" the patented technology in the United States before the critical date of the patent, but neither that section nor the rest of the bill explains the result of the bestowing of that status on the person. In other words, the bill does not say that such a person may then "make, use and sell" the patented technology — the acts that constitute patent infringement under Section 271 of the Patent Act — without liability. Neither does it say that persons who purchase, license or otherwise acquire the technology from such a person are not themselves infringers. Indeed, Section 2(e) explicitly states that "shrink wrap" licensees, the customers of our member companies, would be subject to infringement charges.

Section 2(d) of the bill adds to the confusion by stating that, as long as variations or improvements of the technology do not infringe additional claims, the rights granted by Section 2(b) "shall include the right to make and use" those variations or improvements. Note what is not explicitly included: the right *to sell* them, the third of the acts that constitute patent infringement. Since the other two acts that can constitute patent infringement are specifically enumerated, and exempted, the most logical interpretation of the bill is that the third such act, the act of selling, is not exempted. And if selling is not exempted in this situation, what basis is there for interpreting the bill as exempting selling where no variation or improvement of the patented technology is involved? The answer, unfortunately, is — very little.

It should be noted in this regard that the patent systems of major U.S. trading partners grant prior users the right to continue to sell a product covered by a later-issued patent. For instance, Section 64 of the United Kingdom's Patents Act of 1977 explicitly provides that a prior user may continue, after the patent issues, to perform all those acts that it was performing or preparing to perform before the priority date, including disposing of the later-patented product. If, as Commissioner Lehman stated in his testimony last month, the goal of the Senate bill is to harmonize U.S. patent law with the patent laws of our major trading partners, then the bill must make clear that the prior user right includes the right to sell products covered by later-issued patents.

IV. The "End-User" Problem.

In addition, under the Senate bill the prior use defense is available only to persons who prepared for or actually began commercial use of the claimed subject matter prior to the critical date. Insofar as commercial use is defined as "use in interstate or intrastate commerce," the defense apparently would not be available to any person who had acquired and used software for private, non-business use, for example, home or academic use.

The bill's provision that the prior use right is not transferrable except in connection with the sale of a business means that, even if a software company, by virtue of its prior commercial development of the software, has a viable infringement defense with respect to its sales of the software (a matter about which the BSA has grave doubts, as expressed above), the purchaser/end-user of the software who is not using the software "commercially," does not. This leaves a serious problem for BSA members. Software makers are primarily in the business of selling software, not using it. It does not aid software makers very much to have a right to sell software to persons who have no legal right to use it.

Other countries have addressed this issue by placing those who purchase patented products from sellers having prior user rights on equal footing with those who purchase such products from the patent owner. Again, with reference to U.K. law, customers of the prior-user seller are "entitled to deal with the product in the same way as if it had been disposed of by" the patentee, U.K. Patents Act of 1977, Sec. 64(4), thereby ensuring that the prior user's right to sell later-patented products has some practical value. As with the issue of the prior user's right to sell, harmonization of the Senate bill with foreign patent systems would require an appropriate amendment to deal with the purchaser/end-user problem.

V. The Transferability Problem.

I just addressed one problem the BSA has with Section 2(e) of the Senate bill. On a different, but related, subject, we believe that this provision of the bill is unduly restrictive in that it would not permit the personal use defense to be transferred to an entity that bought an entire software product or product line from a person having the defense available. As drafted, it instead only applies to the transfer of an "entire business or enterprise." Since software proprietors often sell all rights to individual products but not their entire business, the restriction is significant and, in our view, unduly harsh. The BSA does not believe the policies being accommodated in the bill would be harmed if the personal defense was broadened to cover this form of transfer.

VI. Definition of "Critical Date".

My last comment on the Senate bill concerns a semantical problem that could create some confusion if the bill becomes law. Under the bill, a person would acquire prior user rights by commercially using the later-patented invention before the "critical date," which Section 2(a) of the bill defines as "the filing date or the priority date, whichever occurs first, of the application." This definition of "critical date" does not comport with the common usage of that term in the patent field. The term "critical date" as used by patent practitioners means the date *one year* prior to the earliest U.S. filing date to which the applicant for patent is entitled. To avoid causing any confusion as to the established meaning of "critical date," the BSA recommends that the term be called something else or that the term "critical date" appearing in Section 2(b) simply be replaced with the definition set forth in Section 2(a).

VII. Conclusion.

We appreciate having the opportunity to present these remarks and look forward to working with the Committee should it decide to draft legislation to address this issue.

Mr. HUGHES. Thank you, Mr. Hollyman.

Mr. Budinger, that is another vote. I hate to tell you, I am going to recess for another 10 minutes. I will get back as soon as I can to take your testimony.

[Recess.]

Mr. HUGHES. The subcommittee will come to order.

I hope that is the last vote, but we will see.

Mr. Budinger.

STATEMENT OF WILLIAM D. BUDINGER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, RODEL, INC., NEWARK, DE

Mr. BUDINGER. Thank you, Mr. Hughes. I appreciate the opportunity to be here.

Since everything is covered in my written testimony, I will be very brief and underline just a couple of points. There has been some discussion about whether our case is a singular case, and I would just like to make the point that the example that I give in my written testimony is one of several that have occurred just to us, and that rather I expect that there are quite a few of these out here. As I have gone around and talked to my colleagues in the business world, they all say that they have similar experiences to ours. So it does seem that there are quite a few out there like us that have found process patents on the things that they have been doing on their factory floor. And the key in ours is that we saw foreign patents issued on processes that we have been using for as long as 20 years.

I want to talk about the trade secret issue for just a moment. Most of the elements of technology that are concerned here are not the major inventions like the light bulb or transistors. They are the little tiny things on the factory floor, the development work that goes to make a process or product commercial. And it isn't like we think, whoa, here is a new invention and should we patent it or keep it a trade secret? It doesn't happen that way.

The way it happens is that we don't even think about it. We make these innovations and we don't even register that they may be innovations and may be patentable. They are just a part of the collection of the technology that we create in order to produce the product.

The product itself, we very likely patent because that is something we want a monopoly on. The processes that are involved in the manufacturing part of it, we usually don't even think about as being trade secrets in a small business. So that it isn't—I wanted to make the point that it isn't that we think that we have something valuable here and we decide not to patent it. Although that may happen, in the majority of cases we don't even realize it or think about it. And what occurs later on is the surprise when someone comes along and gets a patent on something that we have been doing for a long time. When we go to defend ourselves and we say, gee, there is nothing written about this in the literature and we are stuck, and that is what the prior user rights bill is trying to address.

I think everything else that I might want to say I will address in questions.

[The prepared statement of Mr. Budinger follows:]

TESTIMONY of WILLIAM D. BUDINGER, CHAIRMAN & C.E.O.

RODEL, INC., NEWARK, DE

ON

PRIOR USER RIGHTS

BEFORE THE

SUBCOMMITTEE ON

INTELLECTUAL PROPERTY AND JUDICIAL ADMINISTRATION

OF THE HOUSE COMMITTEE ON THE JUDICIARY

September 13, 1994

2:00 P.M.

Mr. Chairman and Members of the Subcommittee:

My name is Bill Budinger. I am both an inventor and the founder of a small manufacturing company. As an inventor I hold several dozen patents in the U.S. and overseas. I derive significant income from licensing some of those patents. I am very interested in maintaining a strong patent system and strong patents.

My company, Rodel, got its start in my bathtub 25 years ago as I tried to make one of those inventions. The company grew by its own resources and today employs about 300 people in the U.S., another 100 around the world. Our primary products are polishing pads and slurries that are used by the electronics industry in the manufacture of micro-chips, LCD screens, and memory storage devices.

I am here today partly as a result of my company's effort to continue supplying our markets as those U.S. markets moved offshore. In 1979, 90% of our customers were American. In the 1980's, most of those American customers went bankrupt, got bought out, or moved offshore. Survival for us meant becoming global and learning how to compete with firms like Dai Ichi, Fujibo, Fujimi, Marubeni and Mitsubishi. It meant learning how to make products with quality that was better than the best in Asia. It meant trying to persuade a foreign customer to buy American - while our foreign competitors waited in his lobby. My company still exists because we were successful. Today, the majority of our business is supplying products to foreign owned customers. We have a huge export surplus. In fact, I am pleased to report that our American-made products are preferred in Asia even over Asian made products - so much so that in our specialty we sell more in Asia than all of our Asian competitors combined. In fact, it is not possible to buy an electronic product made anywhere in the world that was not made with at least one of our products.

The issue that brings me here today is concern about the vulnerability of our company and many other small American enterprises in the intellectual property area.

Partly because of our success in Asia, our Asian competitors have shown a keen interest in our technology. About a year ago we were astonished to learn that it was possible for them to get U.S. patents on parts of our manufacturing process and then stop us from making what we had been making for years.

Here is one example of what happened:

> **For years our company has been manufacturing one of its principal products by using a process involving heat. When we first began making the product almost 20 years ago, it did not occur to us that something as simple as a particular heating process might be patentable. A few years ago, a foreign competitor filed a patent in their own country claiming the use of heat to manufacture a product just like ours. They then filed for and received a U.S. counterpart patent. We now find ourselves facing a new U.S. patent on a process that we developed 20 years ago and have been using ever since to make products in our plant. The foreign company that holds the new patent is a huge corporation. It dwarfs our small enterprise. If they choose to enforce their patent, they have the financial horsepower to overwhelm us. There is no clear U.S. law that protects us. Our attorneys tell us that under existing U.S. law, the holder of a valid patent on our process would probably be able to stop our production.**

We were surprised to learn that someone could get a new patent on a process that we had been using for such a long time. We had understood American patent law to say that after one has been commercially using a process for more than one year, it can no longer be patented. We, like most U.S. inventors, mistakenly believed that if we were first or have been using technology for more than a year, it cannot be successfully patented by another. Most of us are not aware that our use of technology is not necessarily a bar to some one else coming along much later and getting a patent on it.

The technology that is vulnerable is not the technology of major inventions like the steam engine, electric light or transistor. Because such inventions are finished products and get public notice, they cannot be subsequently patented by others. The technology at risk is the mundane everyday little pieces of confidential manufacturing technology that give a manufacturer his particular competitive edge.

The thing that makes such technology vulnerable is that it is confidential. Even old technology that is not publicly known might be patentable by someone who newly discovers it. Because the present law is unclear on this issue, our patent attorneys tell us that the only sure protection is not to have anything be confidential - to publish or patent every single piece of technology. But running a manufacturing business on such a basis is not practical. It is much easier to copy than innovate. If manufacturers must publish all their confidential technology, their competitors get a tremendous windfall.

The other available option - patent everything - imposes an even more onerous burden. Patents are expensive and their prosecution takes precious time away from new innovation or running the business. For this reason, inventors and small companies generally try to patent only those inventions that they intend to sell on the open market. The hundreds or thousands of little innovations that are incorporated in their tooling, processing, software, or intermediate materials are rarely patented. Furthermore, because the confidential technology resides on the factory floor or behind closed doors, patents for processes, tooling or intermediate materials are extremely difficult to enforce. It is often impossible to know if such patents are being infringed - especially overseas.

Another very important consideration regarding the cost of patents is that domestic patents alone are no longer adequate even for small enterprises. More and more, the survival of America's small enterprises will depend upon their global competitiveness. Since our foreign competitors are free to read U.S. patents (and soon even our applications may be published), they gain immediate access to our technology. If we are required to defensively patent all our processes, the only way we can globally protect ourselves is to file counterpart patents all over the world. The burden is huge. For example, the cost of obtaining full European patent coverage for just one invention is $88,000 in application and maintenance fees alone. That doesn't include Asia, it doesn't include the costs of translation or legal fees, and it doesn't include any of the costs of enforcement. In other words, worldwide patenting has become so expensive that small enterprises are effectively precluded from patenting any but the most important of their inventions - usually a tiny fraction of the total of their innovative technology.

There is, therefore, no reasonable means under existing law to defend ourselves against those who could take away our right to use our confidential technology. America's major trading partners have already addressed this issue and protected themselves. They avoid the

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danger of losing their confidential technology by incorporating "prior user rights" into their patent laws. Prior user rights are a little like a "grandfather clause." Under a prior user right, if a patent issues and someone else can prove that he has been using the technology since before the priority date, the law would allow continuation of that prior use.

Speaking as a patentee and first inventor, I believe that prior user rights are not a threat to a legitimate first inventor. Consider for a moment the sequence of events necessary to produce a patent application versus the events necessary to establish legitimate prior use. The inventor may apply for his patent after he has merely conceived of the idea or he may try to reduce it to practice and make some determination of its commercial potential before filing his application. On the other hand, to qualify as a prior user, one must do everything the inventor does plus do the planning, engineering, and investing in plant and equipment, all before the other inventor files his application. In the real world, it is very unlikely that a prior user could do all that before a legitimate and diligent first inventor had filed for his patent.

Nor do prior user rights deny the public the benefit of such technology. Prior user rights are only an issue for that technology which has, by definition, been invented more than once. Since the prior user is given no monopoly, subsequent inventors are free to commercialize (and perhaps even patent) the same technology. The public gets its benefit both from the prior user and the subsequent patentee.

As things stand now without prior user rights, American manufacturers are not operating on a level playing field with their foreign competitors. If we get a patent on their technology, their prior user right allows them to keep operating. If they get a patent on our technology, they can shut us down. Among all the major trading nations of the world, America is alone in not protecting its native industry with prior user rights.

The Prior User Rights Act of 1994 will correct the problem. It will grant to American enterprise a clearly defined and limited prior user right. It has been crafted to take into account the concerns of the major parties at interest. It strikes a balance between the rights of a legitimate prior user and the rights of a legitimate inventor. It places the burden of proof on the prior user. It is a national bill - it benefits only those who use technology on American soil. Because it confers no benefit to offshore enterprises, it is not useful as a "trading chip" in trade negotiations.

Attached to my testimony are several letters that give important perspective to this bill.

The first letter summarizes the U.K's experience. They report that enactment of prior user rights in the U.K created no adverse effect on their patent system.

The second letter is from the Association of University Technology Managers. AUTM has vigorously opposed prior user rights in the past, and some AUTM members remain opposed. I believe their decision not to actively oppose this particular bill is based upon the bill's balance and the obvious need.

The third letter is from Dr. Robert Gore, president of W. L. Gore & Associates. In addition to his renowned innovative management techniques, Dr. Gore is a great inventor. Among his many contributions to American technology is the product known as Goretex. Dr. Gore's support of prior user rights is significant because he was the patentee and plaintiff in the often quoted Gore v. Garlock case. The unsuccessful defense against Gore's suit was partly based on a claim of prior use.

The final letter is from Lanxide Corp. Lanxide is a small company heavily devoted to research and development. Lanxide holds over 3000 world-wide patents. Their future depends on the strength of those patents. Lanxide's letter explains why a good prior user rights law is important even to those who rely heavily on patents to protect their research investment.

We do not desire to have a monopoly on our confidential technology. We only desire to be allowed to continue using it. Given the growing number of process patents now being issued in the U.S. to foreign entities, the risk is building. We need a good prior user rights bill.

All of us in industry who have followed the progress of this bill hope that it can be passed in this Congress.

Thank you. I look forward to answering your questions.

CONFIRMATION COPY

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NND/jt

MAR 11 10 March 1994

Mr. Bill Budinger
c/o Rodel
451 Bellevue
Newark
DE 19713
USA

BY FACSIMILE
TO: 010 1 302-366 0187
ONE PAGE

confirmation by airmail

Dear Bill

PRIOR USER RIGHTS

You asked me about patent legislation in the UK on prior user rights in relation to granted patents.

In the UK before the Patents Act 1977 evidence of any prior use, whether public or secret, was a ground of invalidity of a patent. Thus if it was proved that there was a prior use of any kind a subsequent patent would be invalid and therefore could not be used to prevent continuation of the existing use. The 1977 Act limited the grounds of invalidity of a patent to lack of inventiveness over the prior art. Prior art is statutorily defined as any matter which was made available to the public. While this definition includes public use it does not include secret use. Thus evidence of secret use is no longer available to invalidate a patent.

It was considered to be inequitable that the patent system should be able to be used to stop tomorrow what someone had been legitimately doing today. A prior user right was therefore included in the 1977 Act which gives to any person, who before the priority date of a patent, does in good faith an infringing act, or in good faith makes effective and serious preparation to do an infringing act, the right to continue with that infringing act. This right is not licensable or separately assignable. It is transmittable only with the business. The burden of proof in establishing a prior user right is on the person who asserts that he has that right. The effect of this additional feature on the patent system has not been of any significance.

I trust the above is sufficient for your purposes.

Your sincerely

N.N. Davis

N.N. DAVIS
Director of Patent Services

AUTM

Association of University Technology Managers, Inc.

June 20, 1994

TO: All AUTM Members

FROM: William Hostetler, AUTM President

RE: **PRIOR USER RIGHTS**

As you may be aware, efforts are underway to introduce Federal Prior User Rights legislation. In order to keep you updated on the progress of this issue, enclosed you will find a memo, "The Threat to Small American Manufacturers," from W.D. Budinger at Rodel, Inc., a copy of the Proposed Prior User Rights Bill as it currently exists, and a copy of a section-by-section analysis of the bill.

The stand being taken by the AUTM Board is as follows: While we would rather not have any form of Prior User Rights or only a limited form that has to be claimed within some reasonable time after a patent issues, we are convinced that Mr. Budinger's proposed legislation is about as limited a form of Prior User Rights as we are ever going to see. Thus, we feel we should either give Mr. Budinger's bill our qualified support or at least indicate that we won't actively oppose it – at least as long as it remains as drafted. Hopefully passage of the Budinger bill will forestall the introduction of a broader form of Prior User Rights of the sort that some of the larger industrial corporations have been pushing.

Members of the AUTM Board have worked with Mr. Budinger to narrow the bill as much as possible and he has tried very hard to meet our concerns because he wants university support. He has a commitment from DiConcini's staff that, if the bill becomes controversial and gets changed, they will see that it is withdrawn from consideration.

The AUTM Board feels that it would be a waste of our efforts to actively oppose this bill but the Board will make clear that any broader form of Prior User Rights would result in our strong opposition.

This is AUTM's position on this issue. AUTM Members should feel free to express their individual opinions to their Washington representatives and to the AUTM Board. We would appreciate it if you would forward copies of any letters you write to Penny Dalziel at the AUTM Headquarters.

PD:hs
Enclosures

Suite S, 71 East Avenue, Norwalk, CT 06851-4903 • Phone: 203-852-7168 • Fax: 203-838-5714

W. L. GORE & ASSOCIATES, INC.

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April 19, 1994

William D. Budinger, President
Rodel, Inc.
451 Bellevue Avenue
Diamond State Industrial Park
Newark, DE 19713

Dear Bill:

Thank you for sending me copies of the proposed "Prior User Rights Act of 1994" and the legislative history that accompanies it.

I believe that enactment of this legislation will help encourage innovation and technological development in the United States. The bill provides needed protection of the rights of prior developers and users of technology while still protecting the legitimate patent rights of patentees.

If I can be of any help in supporting this measure, please let me know.

Sincerely,

Bob

Robert W. Gore
President

RWG/lld

cc: Iain Campbell

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May 17, 1994

Mr. William D. Budinger, President
Rodel, Inc.
451 Bellevue Avenue
Diamond State Industrial Park
Newark, DE 19713

Re: Proposed Prior User Rights Act of 1994

Dear Bill:

We have reviewed your proposed legislation entitled "Prior User Rights Act of 1994" (the "Act") and your discussion and explanation attached thereto. We believe that the proposed Act is logical and provides needed protection to companies like Lanxide.

As you are aware, Lanxide Corporation and its eleven commercial ventures are all based on the creation, protection and commercialization of technology. Lanxide has made extraordinary efforts to protect its technology via the patenting process. Specifically, Lanxide has over 3200 U.S. and Foreign patents or patent applications pending. However, even though Lanxide relies heavily upon the patenting process for the protection of technology, we still feel somewhat exposed absent some type of prior user rights law in the United States.

Bill, as you well know, technology never sleeps and yesterday's full disclosure in a patent can be made at least partially obsolete by today's new discoveries. It is virtually impossible to patent every single new discovery that is important in a commercial process. While it is true that we are not fearful that someone could practice our technology because of our extensive patenting, we are concerned that some company having less than noble technology advancement motives could torpedo various aspects of our commercialization activities. In this regard, the possibility exists for another entity to patent specific improvements that we might be practicing. Such an entity could not practice the improvements that we were practicing because of our dominating patent position. However, we could no longer practice what we had been practicing because of the existence of a patent issued to another. This situation is not healthy to commercialization in general or to commercialization of advanced material and other critical technologies, like the technologies of Lanxide.

Mr. William D. Budinger
May 17, 1994
Page 2

In fact, we believe that the need for a prior user rights law is now more important than ever due to increasing worldwide competition, industrial espionage, etc. The absence of an adequate prior user rights law is likely to actually have a chilling effect upon technology development in the United States.

If we can be of any help in supporting your proposed Act, please feel free to contact us.

Cordially,

Marc S. Newkirk
President and Chief
Executive Officer

MSN/kem

cc: Mark Mortenson

Business Software Alliance

2001 L Street N.W.

Suite 400

Washington, D.C. 20036

TEL 202.872.5500

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STATEMENT OF
THE BUSINESS SOFTWARE ALLIANCE

Before the Commissioner of Patents and Trademarks

February 10, 1994

I. Introduction

Mr. Secretary:

My name is Dianne Callan. I am the Deputy General Counsel of Lotus Development Corporation of Cambridge, Massachusetts. I am appearing here today on behalf of the Business Software Alliance ("BSA"). On behalf of the BSA, I would like to thank you for convening this hearing to consider the many issues associated with the patenting of software-related inventions. We appreciate having the opportunity to participate in this hearing.

The BSA was organized in 1988 to promote the continued growth of the software industry through its public policy, education and enforcement programs in the United States and more than 50 other countries throughout North America, Europe, Asia and Latin America. BSA members are actively involved in nearly all aspects of microcomputer software development, including, for example, the production of operating systems, application programs, and networking software. Current BSA members participating in this statement include: Aldus Corporation, Apple Computer, Inc., Autodesk, Inc., Intergraph Corporation, Lotus Development Corporation, Microsoft Corporation, Novell, Inc., and WordPerfect Corporation.

II. The Software Industry's Contribution to the U.S. Economy

In the last five years, every governmental, academic and industry study of technologies that are key to America's future has identified the vital role to be played by the software industry. Software is characterized by both rapid technological innovation and widespread use in downstream markets. Software innovation improves the competitiveness of other industries which utilize software products to make themselves more innovate and competitive. The benefits of continuous software innovation permeate much of the american economy.

In march of last year, the BSA released a study prepared by Economists, Inc. entitled *The U.S. Software Industry: Economic Contribution in the U.S. and World Markets.*[1] Based on government and industry information the study reviewed the economic contribution made to the American economy by the U.S. "core" software industry: prepackaged software; custom computer programming services; and computer integrated design.

The Economists, Inc. study found that the "core" software industry:

(1) Is the fastest growing industry in the United States;
(2) Is now larger than all but five manufacturing industries;
(3) Is contributing to the economy of virtually every state in the nation; and
(4) Is achieving tremendous success in the international marketplace.

Notwithstanding this impressive record, the software industry's role in the growth of the nation's economy will be even more critical in the future as new and more advanced technologies continued to evolve.

III. Views of the BSA

The BSA has several views on the subject of the hearings:

- Strong intellectual property protection is essential to the continued health and growth of the software industry. Software is difficult and expensive to create yet easy and inexpensive to duplicate or steal. Moreover, the real value of software, and the principal assets of software companies, are not tangible factories or raw material inventories. Apart from employees, buildings and computer equipment, the assets of software companies are intellectual property, the technology embodied in the computer programs that are their products.

- The BSA does not believe that a new form of protection for software-related inventions is necessary or desirable.

- There is, however, an urgent need to improve the operation of the United States patent system as it pertains to software-related inventions. Patents continued to be issued which do not appear to meet the statutory mandates of novelty and non-obviousness, and these patents impose a substantial cost on the

[1] Stephen E. Siwek, Harold W. Furchtgott-Roth, Economists Inc., *The U.S. Software Industry: Economic Contribution in the U.S. and World Markets* (March 1993). We have submitted a copy of this study along with this statement.

software industry and on society as a whole. Those aspects of the patent system that permit long gestation periods for patents also cause economic costs to society without providing commensurate benefits.

Members of the BSA have widely divergent views as to the value of patents being granted on software-related inventions. However, all members recognize that the current patent system does not adequately deal with such patents. Therefore, these comments, which are the minimum common points agreed upon by the participating BSA members, primarily suggest procedural changes to the operation of the patent system, to improve its effectiveness regarding the protection of software-related inventions.

IV. Discussion

The BSA respectfully suggests that the following changes would improve the effectiveness of the patent system:

- The patent term should run for a fixed time from the filing date.
- The examination process should be improved:
  - as to the content of the prior art database,
  - as to the accessibility of that prior art database to the examiners, and
  - as to the training and treatment of the examiners.
- Applicants should be encouraged to conduct a patentability search before filing and to present the prior art located in the search to the PTO before the application is examined.
- An opposition procedure should be established, with provisions that ensure expedited results.
- Reexamination proceedings should be strengthened procedurally and expanded substantively to include non-prior art validity issues.

I would like briefly to explain why the BSA believes each of these changes would improve the system.

A. Term Change

An important problem with the patent system is the issuance of patents after inordinately long application periods, brought about by continuation and continuation-in-part applications and, occasionally, interference proceedings. Whatever the cause, the result is the sudden appearance of a patent years after the technology to which it relates has been developed and commercialized. At that point, design-around possibilities may no longer be feasible and the patent consequently can assume an enormously enhanced power to disrupt long-established expectations, for a full 17 year term from the issue date. The BSA supports the Commissioner's intention to establish a fixed term from the original filing date, as that would give the patent owner a strong incentive to have her patent issue promptly, and would in any case reduce the likelihood of the "stealth" patent that suddenly appears after having lain hidden in the PTO for 15 or more years. Furthermore, the spur to an applicant to timely present all claims and applications stemming from a single disclosure would promote additional efficiencies in the examination process. The BSA is gratified to learn that the PTO will support legislation embodying this concept.

B. Strengthened Examination

Most of the prior art regularly available to PTO examiners comprises collections of patents and publications. However, especially in the field of software-related patents, much of the relevant prior art exists not as patents or publications, but rather as companies' internal technical manuals, reference works, bulletins and other similar documents. Thus, often the most relevant prior art is not readily available to examiners of software-related applications. Groups such as the Software Patent Institute have undertaken to compile databases with these types of software-related prior art. It is important, especially in this area, that the PTO expand the universe of prior art on which it typically relies, and improve its access to the universe. The BSA hereby offers to provide ongoing assistance in establishing and providing content for suitable databases as well as examiner training and software tools for searches in those databases.

C. Pre-Examination Search

Because of the quantity of prior art relating to software-related inventions, as well as the diversity of the nature and location of such prior art, the BSA urges that an applicant should be encouraged to conduct a reasonable prior art search, and to present the results of the search to the PTO within a short time after filing the application.

D. Publication of Applications for Opposition

A third party may often be aware of prior art not readily accessible to the PTO and may also be the entity with the greatest interest in preventing the issuance of a patent covering what is in the prior art. The BSA believes that providing an opportunity for submissions during prosecution (as is done in the EPO after publication of the application and EPO search report) would facilitate a more complete view by the examiner of the relevant prior art. In addition, once claims are allowed, an opposition period of sufficient duration to permit reasoned investigations pertaining to those claims would provide the public with a timely and efficient opportunity to submit relevant information pertaining to claims as they are expected to be issued. (Our position is premised on the assumptions that: 1) the fact that the period for filing an opposition to a patent expires, without any opposition actually being filed, would not in any way affect the presumption of validity of an issued patent; 2) any opposition activity or proceeding would take place in an expedited manner, so that the opposition process cannot be used, as it is in some countries, including Japan, to unduly delay the issuance of the patent, to the disadvantage of the patent owner; and 3) if any opposition activity or proceedings would occur appropriate procedural safeguards to limit potential abuses of the process.)

E. Expanded Reexamination

The current reexamination process is generally not viewed as a viable option by opponents to a patent due to the largely *ex parte* nature of the process. The BSA urges that reexamination be modified to provide more of an *inter partes* proceeding, allowing opponents to a patent to feel more comfortable in relying on this procedure to efficiently resolve their concerns in what may be the most efficient forum.

Further, the scope of reexamination proceedings should be expanded to additionally cover all prior art categories, as well as non-prior art validity and enforceability issues, for example, inequitable conduct regarding an applicant's non-disclosure of material prior art during prosecution of an application.[2] BSA acknowledges and supports the Patent Office's intent to forward legislation to Congress making reexamination a more attractive vehicle for challenging a patent's validity.

We appreciate having the opportunity to present these remarks.

[2] See, e.g., *LaBounty Mfg., Inc. v. U.S.I.T.C.*, 958 F.2d 1066, 1074 (Fed. Cir. 1992).

Mr. HUGHES. I presume much of innovation is incremental over a period of time.

Mr. BUDINGER. That is correct.

Mr. HUGHES. Improvements and suggestions in the workplace, oftentimes by employees?

Mr. BUDINGER. That is right. Even things that show up in the suggestion box, if someone wanted to craft them in that format.

Mr. HUGHES. After you develop a process, it is fairly sophisticated after a number of steps. Why not patent it at that point? What deters you from doing that?

Mr. BUDINGER. A couple of things. One is it is very, very difficult to enforce a process patent. If we have a competitor in a foreign land, if we get a process patent in the United States, he is free to read that process patent and if he chooses to copy it in his country, and not tell the world that that is what he is doing, we have almost no way of enforcing our patent. Even if a competitor in the United States were to choose to copy it, it is very difficult for us to know that he is, in fact, copying our process.

The second thing is that in a global economy it is incredibly expensive to patent around the world. The Commissioner talked about an $80,000 cost for just one invention in Europe. And in today's global economy you cannot really get patent protection unless you patent in the major industrial countries. If you patent only in the United States, you give everybody else a free cookbook on how to practice your invention and the cost of patenting overseas is so huge.

Mr. HUGHES. Mostly cost?

Mr. BUDINGER. Mostly cost.

Mr. HUGHES. Professor Merges, instead of adopting the concept of prior user rights, why don't we change the patent law to permit prior secret use to defeat a patent?

Mr. MERGES. That would solve part of the problem, in the sense that prior users would no longer be frustrated by a subsequent patentee, but I think it would amount to throwing the baby out with the bath water because the subsequent patentee is doing us a service when he or she comes along and files a patent application and it is ultimately issued. They are disclosing the technology and hopefully they are also going to commercialize it.

So rather than destroying the property right along the way towards protecting the prior user right, why not carve out a very limited set of rights for the prior user?

The way I think about it, imagine you had a dispute with your neighbor, you were walking across her property for 10 or 20 years and she no longer wants you to do that. If we had a legal rule that says you have to destroy the title to her whole property parcel in order to continue to walk across the corner, that unnecessarily raises the stakes of your dispute; in order for you to get what you want, you have to do something that I think is overbroad and highly destructive, which doesn't make sense.

Mr. HUGHES. The Committee on Patent Law Reform and Prior User Rights included a recommendation that stated, and I quote: Where the totality of circumstances make it appropriate, a court should have the authority to assess appropriate and reasonable royalties in favor of the patentee.

Do you think such a provision should be a component of a require user rights bill? Should a patent holder be compensated at all for pursuing the patent?

Mr. MERGES. I think the general principle of permitting the patentee to, in a sense, acquire exclusivity by making a payment to the prior user, makes more sense. That part of the proposal makes sense to me.

I think our general presumption against compulsory licenses, which is what that is, ought to lead us to say, at the very least, give them a chance to reach a bargain among themselves before we resort to some——

Mr. HUGHES. That is why you believe that transferability should include the ability to transfer to a patentee?

Mr. MERGES. Yes, I think from the prior user to the patentee, that kind of transferability should be encouraged and I think that rather than let a court set the royalty rate, which we know from experience in patent litigation can be very expensive and difficult, let the parties do it. Let them do that work for us.

Mr. HUGHES. I believe you indicated that you felt that a prior user should be able to expect a modest expansion of the scope of his patent. Why? Why, vis-a-vis a subsequent patentee, should we permit any expansion?

Mr. MERGES. Well, of course, in the limiting case of someone who is not yet doing anything commercially, not making any commercial sales, we have this notion of serious preparation. Implicit in that is the idea, I hope, that they can make some modest expansion. Otherwise, the prior user's reliance doesn't get them anything. I guess it would be a right to a defense against research use prior to commercialization.

But I think implicit in that is that some modest expansion from preparation to use is appropriate. And I think that it makes sense to carry that over to the problem of some use expanding into a little more use.

Mr. HUGHES. What type of retroactive effect should be contained in a prior user rights bill? Should it apply to all issued patents; not just pending patents?

Mr. BUDINGER. I would like to see it apply to all issued patents, because those are sort of property in existence and what we are talking about here. It should not apply to actions that preceded the bill, but only to infringements that occur after the bill is passed.

If we were to preclude infringements on previously issued patents, first of all, we would remove from the protection that this affords a tremendous body of patents in potential difficulty.

And secondly, I think that often laws about new actions refer to property that is already in existence, so that we are not stepping over the bounds of retroactivity here.

Mr. HUGHES. Anybody disagree?

Mr. MERGES. I think it is a complicated question. I think that retroactivity, although it—although legislation affecting property rights very often does affect property in existence to some extent, on the other hand, we are always very careful to craft bills so that people who relied on the existing state of the law don't get burned by a change in the law.

To the extent that people have made their trade secret versus patent election on the basis of current law, we have to think very carefully about what retroactive prior user rights will do with respect to that election, how it will affect an election that has already been made.

Mr. HUGHES. Are you suggesting that you would make it prospective entirely?

Mr. MERGES. Certainly one conceptually clean approach would be to make it prospective, applying only to prior uses after the date of enactment. I wouldn't say that that is the only way or the superior way, but that is certainly one clean way.

Mr. HUGHES. What would be the appropriate cutoff date for prior user rights to be established? Before the grace period, before the patent application date, or before the patent grant? Anybody?

Mr. BUDINGER. Again, the easiest way to do that is the application date or the priority date, whichever comes first.

Mr. HUGHES. How would you interpret, Mr. Budinger, the prior commercialization or serious preparations qualification for prior user rights?

Mr. BUDINGER. Well, bear in mind that my perspective is from that of a manufacturer, and I can't really address the software issue, which I think is substantially different. But from a manufacturer's perspective, if we are already using the technology to produce a product that we sell that gets out into the public, that that would clearly be a prior commercialization.

It gets a little trickier when we get into the serious and effective preparation, and there what needs to be required is a very clear commitment on the part of the prior user to have gone well down that road toward commercialization, including spending most of the money required to do the commercialization.

And the object here is again to protect somebody who has been working on this thing and getting ready to bring it to market but hadn't quite done that when somebody else came in and applied for a patent.

Mr. HUGHES. Professor Merges or Mr. Holleyman.

Mr. MERGES. Yes, I think two points on that. First, I think, especially for the software industry, it has got to be clear that licensing your trade secret rights ought to count as commercialization, because many times with software consultants, that is how they make their money, by licensing some software code that they have written to a user, so the user can integrate it into another product, or use it in a manufacturing process, or sell it to a bank or to a financial services operation, a lot of different ways.

And secondly, I think the idea of trying the serious preparations to some notion of expenditure, having spent some money on scaling up and turning a trade secret idea into a real process, I think that has some real appeal because that is the kind of investment that I am looking to protect, so why not make it explicitly the measure of when prior user rights come into existence; when you have spent some serious money.

Mr. HUGHES. Mr. Budinger, your testimony refers to the high cost of worldwide patenting and you have alluded to that today, and we have heard others allude to it and your ability to patent everywhere. Isn't it correct that if you do not patent in other countries, your manufacturing activities in the United States will not grant you prior user rights in those countries?

Mr. BUDINGER. That is correct.

Mr. HUGHES. Do you have foreign manufacturing operations protected by prior user right user rights at all?

Mr. BUDINGER. Yes, we do. We have a manufacturing operation in Japan and our user technology there is protected by the Japanese prior user rights.

Mr. HUGHES. As a businessman, would you rather have a majority share of the market for a product or a prior user rights and patent in the product?

Mr. BUDINGER. If it is enforceable, I would much prefer to have a patent, but that is a pretty important if.

Mr. HUGHES. Mr. Holleyman, I think I understand the position of the software industry, and their need to have "commercially used" interpreted or at least understood to include sale as well as licensing. I think that Professor Merges just referred to that.

Let me ask you, you also testified that you believe that there were two other things that were absolutely essential, two other ingredients in your testimony in order for to you receive more than a marginal benefit.

Mr. HOLLEYMAN. The first of those would be to clarify that an end user of the software who might be using it in other than a commercial setting would also be protected from an infringement claim. For example, an academic institution or a home user of software. It should not be limited to the commercial user.

Second, was the issue of transferability. If the prior user right can be transferred as the Senate bill provides, we do not believe that it should be limited to cases in which there is transfer of an entire business. It should also allow for transfer of the right with the transfer of a product line.

Mr. HUGHES. A product line.

Mr. HOLLEYMAN. That is right.

Mr. HUGHES. And why is that latter so very important to you? You suggest that it is the nature of the business, that you would not necessarily be selling an entire business, but a product line as such.

Mr. HOLLEYMAN. Occasionally software companies sell their entire business.

Often when there is a transfer, however, you see the transfer of a product, of a particular software package, rather than the entire company. We simply want to ensure that if that line is transferred, that the prior user right transfers and that it doesn't require the sale of the entire software company to preserve the right.

Mr. HUGHES. What is your response to that, Professor Merges?

Mr. MERGES. I think that that is a line that has got to be policed very carefully.

Mr. HUGHES. Because that really cuts into one of the basic ingredients that you suggest are essential, that is that transferability must be rather limited.

Mr. MERGES. You have to be careful to make sure that the prior user right can't be sold as it is, in and of itself, to the party who most can use it. That would be a serious problem for the subsequent patentee, because it would make sure that the prior user right always wound up in the hands of your highest volume competitor, basically your bitterest enemy in the market, and I think that would be a serious problem.

On the other hand, if a line of business is the usual unit for large scale corporate reorganizations in software, there might really be something to this point. I just want to make sure that it doesn't become an easy back-door way to transfer the prior user right, per se. I think it is something that has got to be crafted carefully in the language to make sure that it doesn't swallow prior user right up.

Mr. HUGHES. Thank you very much. Your testimony has been very, very helpful and we appreciate it very much. As I indicated, I am particularly indebted to you, Mr. Budinger, for sensitizing us to some of your own personal experiences, which I think have helped bring some focus on this very important issue.

Thank you.

Our final panel today consists of Carl Moy, who is a professor of law at William Mitchell College of Law and has been there since 1989. He received his juris doctorate in 1983 from George Washington University National Law Center and a bachelor of mechanical engineering in 1978 from the University of Minnesota. Professor Moy began his career in patent law as a patent examiner with the Patent and Trademark Office. He is presently a member of the American Bar Association, Section of Intellectual Property. He has served as the chair for the ABA Committee on Patent Legislation, which recently reviewed pending Senate legislation on prior user rights.

Our next panelist is Teri Willey, who is currently the associate director for technology licensing for the Purdue Research Foundation. The office identifies, evaluates and markets creation of research in technology programs at Purdue.

Ms. Willey's past experience includes product development and FDA regulatory development for animal health research and the Development Division of International Minerals and Chemical. She previously directed the licensing program at Northwestern University. She has an M.B.A. and advises the Office of Technology Assessment regarding the Human Genome Project.

Our final panelist is Arnold Newman, president and founder of Synexus Corp., an independent inventor, who presently holds over 20 U.S. and foreign patents. Before forming his own company, he worked at Johns Hopkins University Applied Physics Laboratory. He is presently involved in the development, licensing and transfer of his own technology and the technology of others.

We welcome you today. I apologize for the delay in reaching you. We have your statements and I have read each one of them. They will all be made a part of the record and I want you to summarize.

STATEMENT OF R. CARL MOY, ASSOCIATE PROFESSOR, WILLIAM MITCHELL COLLEGE OF LAW, ST. PAUL, MN

Mr. MOY. First, I would like to make a bit of a clarification. Despite my presence on the "con panel", I am not totally opposed to prior user rights. I find them useful in a very limited context. I am, however, very much opposed to prior user rights when used as means of immunizing trade secret holders from liability for patent infringement.

I am going to structure these remarks to give some background information on prior user rights to show how I look at them. Second, I would like to talk about where I see them being useful, and where I don't see them being useful in U.S. patent law. And then I am going to close with recommendations' where I will talk about trade secret holders and their relationship to prior user rights.

First, I think you have to understand when you are listening to me that I look at prior user rights as being a form of compulsory license. I think that is well accepted among economists. It is quite clear that the value of patenting basically stems from the ability that a patent gives its owner to control the quantity and, therefore, the price of a good that is in commercial use.

What happens with a prior user right is it forces the patent owner to share that market with everyone else. The patent owner loses control of the quantity term; he or she no longer has 100 percent market share and now the price is driven down closer to the competitive level. It reduces the profit incentive.

This is true with any compulsory license. And it is also true with regard to prior user rights. So we can see that prior user rights would have a cost if they were to be introduced in the United States system. We would see that the profit incentive, the potential for profit from patenting, would decline to the extent that prior user rights are valuable.

And we would also see—if the other assumptions that underline the patent system are correct—a decrease in the level of patent-driven innovation and probably a slowdown in the rate of innovation to some degree.

On the other hand, we would also see some definite benefits from introducing prior user rights. A patent is by its nature an anti-competitive device. And when you have a prior user, you have two entities in the marketplace, probably a lower price and something that comes closer to a perfectly competitive market during the term of the patent.

The cost associated with the economic dislocation of someone betting incorrectly that a patent will not issue will probably be somewhat decreased.

In the international sphere, things look more difficult. It is clear that, when you give an economically valuable patent to a foreign entity, it operates as a net deduction from the national wealth. Typically, the foreign entity withdraws the elevated patent profits from the domestic economy and puts them into the foreign economy.

So, to the extent that one can systematically diminish the value of patents, one can thereby decrease the hemorrhaging of national wealth that occurs through foreign patenting. And in the United States the latest statistics are that 40 to 45 percent of our patents are being taken out by foreigners. That is quite different from the historical period where the law formed, by the way.

Therefore, the extent that prior user rights will decrease the value of patents and increase the rights of domestic entities, then we will probably see a foreign trade benefit as well.

I think that kind of analysis underlies most of my views of prior user rights.

Now, in the domestic patent system in the United States, I don't think that we will see the same kinds of benefits from prior user rights, that would be the case if we were in a foreign country, particularly one that uses a first-to-file system.

We have first-to-invent priority in the United States. That means that, on most occasions, the prior user is the first inventor and usually will be able to prove his or her activities as prior art. And having done so, he or she will receive an absolute immunization from patent infringement, not only for what he or she is doing now, but anything that is obvious over that as well.

I will give you an example to show you, I think, the extent of this point. I will note for the background that I am looking at a press release from the Rodel Corp. dated March 13, 1994, in which the factual summary of Rodel's situation is that a foreign company analyzed its product and determined how Rodel made that product using heat. It states: "A fairly easy analysis to make." The implication is that this heat process is the technology that is covered by the foreign patent. If that is truly the case, then the Rodel Corp. has not only generated potential prior art under section 102(g), but they have probably also generated 102(f) prior art and prior art under 102(a) and 102(b).

So if, in fact, Rodel's situation is shown to be as in this release, we see that Mr. Budinger's case is in fact not one whose outcome is going to be changed by the introduction of prior user rights into the United States. The U.S. patent system already identifies him as someone who will be able to operate free and clear of patent liability.

When you take a careful look at it, in fact, you find that prior user rights will affect essentially only two classes of persons in the United States: second inventors who have not generated prior art activities before the critical date under 102(b); and first inventors who have suppressed or concealed the invention under 102(g)—essentially, trade secret holders. These are the two classes of people that prior user rights have the potential to affect in the United States.

My recommendations are that prior user rights be enacted with regard to the first class of persons. Typically, these persons are not going to be numerically very large. Also, for reasons a bit too arcane to get involved with, in my oral remarks the award of prior user rights in that kind of situation would ameliorate some of the balance-of-trade effects of the changes to the patent code, particularly section 104, that have been made in light of NAFTA and will likely be made in light of GATT. I would recommend—since I would assume foreign countries are going to do the same sort of things to us—that we should consider doing that to them.

On the other hand, I am very much opposed to granting prior user rights to trade secret holders. Patents systemically impose costs on a country. Every time you grant a patent, it imposes costs on the country. So we don't give patents away for free. The patent system is designed to require that we receive certain things in exchange for the patent right. For example, we put a time limit on the right. The time limit is currently 17 years from issuance. It will soon be 20 years from filing.

Also, we insist that the right be accompanied by a full public disclosure of the technology that is subject to the right. We do this so that knowledge of the technology can enter into the public domain and be used to further other people's research and development, and also to spur the development of alternate technologies.

An article by Professor Merges, in fact, has eloquently proven albeit in a different context, how critically important that competitive race to research and development can be in maintaining the pace of innovation in a particular country.

The trade secret user, on the other hand, is operating in a completely different regime. The trade secret user has made a calculation that single source pricing can be imposed on the marketplace for a longer period of time by opting out of the patent system. And the trade secret user also does this in combination with systematically denying to competitors and others the technological information that could be used for further competitive advances.

And so there are many reasons why, as a policy matter, one should encourage the use of patenting and discourage the use of trade secrecy. It is important to recognize that, in a typical case, the trade secret user is not an innocent who has happened to bump up against a patent. He has made a cold, calculating, economic decision, and it is one that may often not be in society's best interest.

I would recommend an alternative to prior user rights in this area. Rather than abandon the patent system or admit that it is somehow not capable of supplying what is necessary for these people, I would work to improve the patent system. So that people like Mr. Budinger will not be disadvantaged by the system, because he is not apparently a trade secret user as the patent law would define that. I think that I could see changing the definition of suppression and concealment in section 102(g) of the patent code to include a showing of intent, to further narrow the definition. And one thing we can do is to grant increased discovery powers to people who are inventors of process technology, so that some of these potentially legitimate problems that they have identified can be rectified. We are now in the process, in fact, as I am sure everyone here knows, of drastically reformatting the discovery provisions in the Federal Rules of Civil Procedure. I think that it would be possible to address the concerns of process inventors in this context as well. These would be much smaller changes and have much less far-reaching implications than including broad prior user rights into the patent law at this time.

Thank you. That concludes my remarks.

[The prepared statement of Mr. Moy follows:]

STATEMENT OF R. CARL MOY

ASSOCIATE PROFESSOR
WILLIAM MITCHELL COLLEGE OF LAW

ON PRIOR USER RIGHTS

BEFORE THE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY
AND JUDICIAL ADMINISTRATION

OF THE

COMMITTEE OF THE JUDICIARY

UNITED STATES HOUSE OF REPRESENTATIVES

September 13, 1994
2:00 p.m.

Mr. Chairman and Members of the Subcommittee:

I am pleased to testify at this oversight hearing. I favor amending United States law to give prior user rights to second inventors who have not generated invalidating prior art. Broad prior user rights, however, can drastically upset the current balance between patents and trade secrets. It would be imprudent, in my opinion, to make such a change without careful study and without exploring less drastic alternatives first. I therefore oppose giving prior user rights to persons who have chosen to hold the subject technology as a trade secret. For that reason, I oppose the Patent Prior User Rights Act of 1994, S.2272, in its present form.

1. *Prior User Rights Generally.*

Generally speaking, a patent gives its owner the right to exclude others from exploiting the patented subject matter. The term "prior user right" usually refers to an exception to this right, given to one who has obtained the patented subject matter before a particular event in the patentee's efforts to invent and patent. The event is usually the date on which the patentee filed the application for patent. That is, prior user rights are usually given to persons who obtain the patented technology by the filing date of the particular patent at issue. The right is a specific form of compulsory license.

The formulation of a prior-user right is, in theory, highly variable. The right can be made conditional, for example, on the payment of compensation to the patent owner. It can be given to those who derived the technology from the patentee. The extent of the right can be enlarged to include future-developed improvements or other related technology, or limited to the extent of use at the time of the patentee's filing. The right can be made transferable, either freely or under certain conditions. The right can be made available to trade-secret holders, or to persons who have invented, but not yet commercialized the technology. An award of the right can be placed in the discretion of the court.

In my testimony I will address the most common form of prior user right: A right that is royalty free, given to one who obtains the subject technology prior to the patentee's date of filing.

2. *The Effect of Prior User Rights on the Patent System, From a Domestic Viewpoint.*

The patent system is generally thought to be effective because it increases the benefits that inventors receive from the act of inventing. Once awarded, a patent permits its owner to control the quantity of the patented invention that is commercially available. Assuming the patented invention is commercially significant, the patent owner is therefore able to increase his or her profits above a competitive amount for the life of the patent. The expectation of these increased profits will spur prospective inventors to invest resources in research and development, thus increasing the likelihood that invention will actually occur.

The patent system imposes costs on society as a part of achieving this benefit. Primary among them is perhaps the higher price, and the associated under-use of the invention, that occur while the patent is in force. As a policy choice, the patent system reflects the judgment that the benefits of patenting exceed the costs.

The award of prior user rights changes the balance between cost and benefit that would otherwise exist in a patent system. The inventor's expectation of increased profit depends on single-source control over the patented technology. Prior user rights, by definition, interrupt that control -- the patent owner must share the market with the prior user. A necessary result, then, is that the inventor's expectation of profit is diminished. The prospective inventor will likely invest in research and development less heavily; the rate of invention should therefore slow. At the same time, however, prior user rights create a more competitive market in the patented technology. Prices should therefore be lower where a prior user exists; use of the patented invention should be nearer the social optimum. In addition, awarding prior user rights promises to decrease the disruption in economic activity that would otherwise occur when a patent unexpectedly issues on technology that is already in use.

When viewed in light of purely domestic concerns, therefore, whether to incorporate prior user rights into a patent system is a question of whether the resulting benefits from increased competition outweigh the damage that prior user rights will do to the incentive function of patents. The size of these factors can be controlled by selecting the legal contours of the prior user right so as to make the right more, or less, economically important. In general, however, bestowing large benefits on consumers and competitors will come only at the price of imposing large costs on patentees.

3. *The Effect of Prior User Rights on the Patent System, From an International Viewpoint.*

When made available only to domestic entities, prior-user rights have a protectionist effect.[1] Patent rights transfer increased wealth from consumers to patent owners. When a foreign entity owns the patent at issue, that entity draws the increased wealth out of the patenting country and into the country of the patent owner. Prior user rights, in contrast, are typically granted only to prior users who are domestic. To the extent that such rights are valuable, then, they transfer wealth from a class of persons with a potentially large foreign character to one that is almost entirely domestic. Granting prior-user rights therefore stems part of the loss of domestic wealth due to international patenting. Put another way, prior user rights distort the balance of international trade in favor of the granting country. There are some indications that this protectionist quality is a primary reason for the widespread presence of prior-user rights in the patent systems of foreign countries.

Approximately 45% of United States patents are currently granted to non-United States entities. Thus, enactment of a prior user rights provision limited to domestic U.S. activities should have the protectionist effect noted.

4. *The Relationship Between Prior User Rights and First-to-File Priority.*

Proponents of prior user rights have noted that such rights are widespread in the laws of foreign countries. The argument is apparently that the presence of such rights represents a consensus that they are beneficial in the patent systems of those countries and that, accordingly, they would be beneficial in the patent system of the United States.

I do not believe that the existence of these foreign laws can be used to prove so much. Individual legal rules necessarily coexist with other factors, both legal and cultural. The rationale for a particular legal rule in a foreign country, and the results that flow from

[1]There is therefore a question whether prior user rights are GATT legal. My testimony does not address this point further. I do note that prior user rights of the type under discussion in this section are widespread in the patent laws of other countries.

it, can therefore be very difficult to find. Authorities in the field of comparative law generally advise extreme caution when offering conclusions as to how an isolated legal rule from one country will operate in another.

An excellent example of these difficulties can be seen by considering the relationship between prior user rights and first-to-file priority. Like virtually all property regimes, patent law generally bestows priority of title, among rival claimants, onto the person who achieved the relevant status earliest in time. In patent law, however, there is a considerable international disagreement over what the relevant status should be. Under United States law, priority is given to the first inventor. The rule is generally thought to flow from a recognition that invention is the centrally important act in a patent system; it may also derive somewhat from historical times when communications with the government were difficult and time consuming. Under the modern patent laws of nearly every other country, in contrast, superior title belongs to the person who first files an application for patent with the government.

The foreign system of first-to-file priority is clearly based largely on the administrative efficiencies that such a system makes available. In a first-to-invent system, priority contests require resolving the difficult questions of who invented what, and when. In a first-to-file system, in contrast, priority contests are resolved easily, by comparing application dates. Operating a first-to-file patent system is therefore cheaper and quicker.

Implicit in these foreign systems is the decision to value administrative efficiency over the equities of a first inventor who delays applying for patent. First-to-file priority thus can produce harsh results in individual cases. This is particularly true where the losing party has decided to forego patent protection entirely, electing instead to introduce the new technology into the marketplace without the legal right to exclude competitors. In such a case the losing party was willing to create a competitive economy in due course, and now finds itself potentially excluded from the market by a single-source patentee.

In a first-to-file system, then, prior user rights are a means of ameliorating the injustices of deciding priority solely on the date of application.[2] The basic rule of first-to-file priority is peculiar in that it assume all inventors, and all inventions, enter the patent system. This is obviously incorrect. In situations where an inventor could have filed first, but did not, prior user rights preserve for the inventor the right to use the patented technology. This is perhaps not as just as awarding the first inventor the right to patent. It is, however, substantially more just than stripping the first inventor of both the right to patent and the right to use.

The prior user rights of foreign patent systems therefore cannot be separated from first-to-file priority. Prior user rights supply a range of benefits to other countries. Whether such rights would still be justified if only some, but not all, of those benefit were available is something that foreign experiences simply do not address.

5. *Prior User Rights Under Current U.S. Law.*

The preceding example is particularly important to this oversight hearing because the United States does *not* use first-to-file priority. As a result, some important advantages that foreign systems derive from prior user rights would not result here.

This can be seen in the limited classes of situations to which prior user rights would apply in the United States. True, the United States does not currently award prior user rights, *per se*. But the activities of a prior user can be prior art against the patentee. If they are, the prior user's activities remain free of any claim of infringement.[3]

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[2]An analogous mechanism appears in national trademark laws that base priority on the date of registration. *See* Paris Convention for the Protection of Industrial Property, as Revised at Stockholm, 1967, art. 6[bis].

[3]As a result, some of the legal literature has tried to assert that the United States employs a form of prior user right, albeit tied to the date of invention, not the date of filing. I do not adopt that position here.

The prior user in the United States is thus clear of patent rights in most cases already. Where the prior user is the first inventor, for example, and has not abandoned, suppressed, or concealed the technology, his or her actions are invalidating prior art under 35 U.S.C. § 102(g). Even as the second inventor, the prior user will still be free if he or she has generated a public disclosure more than one year prior to the patent applicant's filing date. 35 U.S.C. § 102(b). The United States, moreover, generally disposes of patent applications quickly. The economic disruptions from patents issuing unexpectedly should therefore be low. This will be even more true if the United States begins publishing all applications at 18 months after filing.

Installing a prior-user right into United States law therefore can enlarge the rights of essentially only two classes of prior users:

> (1) second inventors who have not injected the patented technology into the public domain early enough to generate prior art under 35 U.S.C. § 102(b); and
>
> (2) first inventors who have abandoned, suppressed, or concealed the technology under 35 U.S.C. § 102(g).

6. *Recommendations.*

A. *Award Prior User Rights to Second Inventors.*

It would be wise, in my opinion, to award prior user rights to second inventors who have not generated 102(b) prior art. Cases falling within this class of fact pattern are likely to be rare. The detriment to the patent rights of most applicants will therefore be small. Consequently, the decrease in the profit expectations of prospective inventors generally will be small as well. The incentive function of the present patent system should not be altered substantially.

In addition, the patentee in nearly every such case can prevent the creation of this type of prior user right. To be a prior user, a second inventor must enter the field before the first inventor files. Thus, if the first inventor files promptly, the risk of a prior user right is diminished. The risk can be reduced to virtually zero by filing a patent application very soon after the invention is made. Awarding prior user rights to second inventors is therefore fundamentally just to the patentee.

Still further, by giving prior user rights to second inventors the United States should receive a measure of the international-trade benefits that have been discussed. In particular, inserting this form of prior user rights into United States law would reduce effects of the GATT and NAFTA-related modifications to 35 U.S.C. § 104. Section 104 previously limited proof of invention to activities in the United States. As a result, U.S. inventors have sometimes received a favorable determination of priority in this country despite having invented later than a competing foreign inventor. NAFTA and GATT have forced the United States to permit proof of invention, for the purpose of obtaining a patent, through reference to activities in any member country. Some U.S. inventors who would have been awarded priority of invention before will therefore now lose.

Awarding prior user rights to second inventors would restore part of the rights that these U.S. inventors have lost. By definition, these U.S. inventors obtained the patented technology after the foreign applicant's date of invention, but before the foreign applicant's date of filing. They are therefore very likely prior users. Under the terms of GATT and NAFTA they cannot receive the right to patent. They can, however, be given the right to use the subject technology free of the foreign applicant's patent rights.

B. *Deny Prior User Rights to Trade Secret Holders.*

Although a few cases can be read to the contrary, the general view is that United States patent law currently does not consider trade-secret use of technology to constitute prior art. Rather, trade secret holders more likely will be held to have "abandoned, suppressed, or concealed" the invention. As such, section 102(g), Title 35, U.S.C., will preclude them from being first inventors. Trade secret holders are thus at risk of being assessed damages, and possibly enjoined, by an independent, later inventor who patents the subject technology.

Awarding prior user rights to persons who have suppressed or concealed[4] their technology would consequently immunize trade secret holders from suit for patent infringement. Indeed, this immunization would be the main effect of granting prior user rights broadly.

I do not favor the creation of prior user rights that are so broad. There is a fundamental tension between patent law and trade secret law. True, a trade-secret holder typically makes the output of his trade-secret technology available to the public. But he does not act out of philanthropic motives -- he prices the output at a level that reflects himself as the single source of the technological advance. A patentee can extract single-source pricing only for a set period of time, and only in exchange for an enabling disclosure. The trade-secret holder, in contrast, seeks to extract single-source pricing for an indefinite period of time, while refusing to disclose the technology.

The patent system currently reflects the judgment that protection of patentable technology through patenting yields greater social benefits than does protection through trade secrecy. The patent system disfavors trade secret holders; it works to discourage innovators away from trade secrecy by the threat of future liability for the infringement of another's patent. The United States Supreme Court has observed, in fact, that encouraging the protection of patentable subject matter via trade secrecy is inconsistent with the United States patent system as presently configured.[5] Thus, even if it were advisable to extend prior-user

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[4]The extreme infrequency of litigation over the question of abandonment, *per se*, suggests that fact patterns under that statutory term are rare. My remarks therefore do not consider that issue further.

[5]*Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470 (1974).

I am aware that others have cited *Kewanee* for the proposition that trade secret protection is not in conflict with the patent law. *E.g.*, Statement of Bruce A. Lehman, Commissioner of Patents and Trademarks, on S.2272 and S.2341, Before the Subcommittee on Patents, Copyrights and Trademarks of the Committee on the Judiciary, United States Senate (Aug. 9, 1994). With all due respect, however, I disagree. The opinion in *Kewanee* is clearly based on the assumption that virtually no one in possession of patentable technology would resort to trade secrets over patenting:

rights to trade holders, such an extension would involve a policy change from that reflected in the current statute.

I am aware that some persons profess frustration with the patent system. The prior-art status of some third-party activities is not clear. Process patent holders find their discovery powers over infringers to be inadequate.

The appropriate solution to these problems, however, is not to drastically reconfigure society's policy choice between patenting and trade secrecy. Instead, incremental changes can be made to clarify the definition of prior art and to accommodate the needs of process patent holders. I offer the following alternatives as a partial list of the available options.

1. *Clarify that information available through reverse-engineering is in public use.* Publicly used technology is prior art. 35 U.S.C. §§ 102(a), (b). This includes, as a general matter, all information that can be discerned from a skilled inspection of public sources. It probably already includes information that can be learned through reverse engineering. One who reverse engineers a trade secret holder's technology thus likely cannot patent it. The law can be clarified to state this more plainly.

2. *Limit "suppression" and "concealment" to situations where the technology holder has the specific intent to prevent public disclosure.* A trade secret holder must take reasonable, purposeful steps to prevent the disclosure of the trade secret information. The presence of a specific intent to suppress and/or conceal therefore distinguishes trade secret holders from those who have simply neglected to take affirmative steps to inform the public. The latter can be treated more hospitably under patent law by defining suppression and concealment to include the presence of such a specific intent.

> If a State, through a system of protection, were to cause a substantial risk that holders of patentable inventions would not seek patents, but would rather rely on state protection, we would be compelled to hold that such a system could not constitutionally continue to exist. In the case of trade secret law no reasonable risk of deterrence from patent application by those who can reasonably expect to be granted patents exists.

Id. at 489; *See also id.* at 490-492. Awarding prior user rights to trade secret holders is, in contrast, based on the opposite premise: that inventors of patentable technology should be encouraged to select trade secrecy over patenting. The Commissioner's reading of *Kewanee* is very difficult to reconcile with later decisions of the Supreme Court, notably *Bonito Boats Inc. v. Thunder Craft Boats*, 489 U.S. 141 (1989) (holding as preempted state statute giving patent-like rights over new technology).

3. *Make enhanced discovery powers available to holders of process patents.* Patent protection can be made more useful to holders of process technology by enhancing the discovery powers of such persons. They could, for example, be given the power to extract prompt technical disclosures from potential infringers. The ongoing modifications of the Federal Rules of Civil Procedure could be used to as vehicle to effect such changes.

The enactment of prior user rights that broadly apply to trade secret holders, such as in S.2272, are therefore premature. The problems voiced by proponents can be rectified by other, less obtrusive measures. At the very least, I would strongly urge that you take time to carefully study the likely economic effects of broadly immunizing trade secret holders from liability for patent infringement.

I thank you for the opportunity to testify, and look forward to receiving any questions that you might have.

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Mr. HUGHES. Ms. Willey, welcome.

STATEMENT OF TERI F. WILLEY, ASSOCIATE DIRECTOR, PURDUE RESEARCH FOUNDATION, OFFICE OF TECHNOLOGY TRANSFER, WEST LAFAYETTE, IN

Ms. WILLEY. My statement will primarily focus on the viewpoints of a university licensing professional, the importance of the right to exclude under U.S. patent law to university licensing, and I am here to make sure that you don't forget the role that universities play in new product development and in the economic health of the country.

I respect that perceptions of prior user rights are couched in the perspective from which viewed. That perspective differs substantially whether the viewer is a manufacturing entity, an individual, a university, Federal laboratory, small business or a large corporation. And the issues impacting the software industry add further complexity and warrant very careful consideration.

I would like to also state that I do appreciate the efforts that have been made to date to address university concerns in the legislation as it is currently written. I am here to represent the university perspective and to ask you to thoughtfully consider this view as you continue to look at this complex issue.

As a professional in university licensing, I have an obligation to the public, the U.S. taxpayers. My institution is a recipient of Federal funds, and I have a fiduciary responsibility to make sure that the public benefits from the support.

I would like you to please keep in mind that new products and services are tangible outcomes of public-supported research, but in order for these research results to be made available to the public, someone must invest in them, transform the idea into at product, manufacture and distribute it and only then it truly becomes available to the public for their benefit.

The tool that we use most often to accomplish this is a licensing arrangement, a patent licensing arrangement, between the university and the for-profit company. This license and the guarantees of the U.S. patent law are the incentives that we can offer to encourage development of publicly funded research results.

Prior user rights can remove this incentive and can discourage this type of commercialization collaboration and this is what I am concerned about. Please understand that the economic impact of university licensing efforts is real. Research and commercialization activities mean jobs for people who carry out the task of new product development, manufacturing and sales. There were over $45 billion dollars in product sales in 1993 attributable to nonprofit technology transfer programs. Tax revenue to State, local, and Federal governments are estimated to be over $9 billion.

Nonprofit research institution technology transfer programs help to create or retain over 300,000 industrial jobs. And this number does not include jobs that are created at universities and medical centers to hire people to carry out industry-sponsored research programs.

University practices are philosophically consistent with the U.S. patent law and our processes and practices are unique in contributing to the base of knowledge. We talk a lot about universities being involved in patent and licensing, but in fact we accomplish most of this by adding to the base of knowledge through publication and we publish even when patents are filed. We accomplish this also through teaching and training of our work force.

As Mr. Lehman has pointed out, the Constitution in fact provides that the Congress shall have the power to promote the progress of science and the useful arts by securing, for a limited time through authors and inventors, the exclusive right to their respective writings and discoveries. In the case of a patent, the right is granted and it is the right to exclude. This right to exclude is very important to university licensing.

Patent rights do not deprive the public of anything as do trade secrets. For example, as an inventor, I would earn the right of exclusion by instructing the public how to practice what I seek to protect. Patent law provides for this trade, and the trade works to help me license technology and see that it is commercialized. Trade secrets do not.

Because prior user rights favor the trade secret, it is contrary to the underlying purpose of the patent system as the secret does little to advance the progress of science.

On a very practical basis, the right to exclude is the essential element in any patenting licensing program and therefore, any university technology transfer program. If the university or its licensee cannot seek compensation from a detected infringer, as a university licensing professional, I lose a very important incentive to offer my licensee and this is an incentive that is required for them to invest in product development. If the university, or our licensee, must seek a determination of whether or not there is a situation of prior user rights or a situation of derivation, there is a disincentive to invest in product development.

Secret prior user rights as a defense against patent infringement constitute compulsory licensing. This is licensing without compensation and I believe there should be compensation to a patent holder in the case of patent infringement.

In the face of uncertainty of the right to exclude under a patent, the opportunity to license that patent is severely diminished. Early stage inventions resulting from university research, use of our public funds, are very risky anyway. Potential corporate licensees and venture capitalists are less likely to advance the risk capital needed for the development, production and marketing of an invention if there is a significant chance that an unlicensed corporation could emerge at any time. This raises the concern of whether or not there should be an assertion of prior user rights within a specified period of time after a patent issues if we are going to have prior user rights.

Again, incentives are lost to develop these federally funded technologies for the public benefit.

Finally, with prior user rights, especially with regard to university inventions, because university inventions are published early, the possibility of derivation is critical and it is real. It is not uncommon for universities to manage cases of infringement where there has been derivation due to our practice of publishing early, and a scientist from a company picking up an idea from such a publication, patenting it, and working toward commercialization with it.

Although prior user legislation calls for prior users to act in good faith, meaning that there should be no derivation, the opportunity for mischief is large. With the established university practice of publishing research results, it is very possible and even likely for a third party who reads a publication or hears a presentation or reviews a poster session or interviews a graduate student or a post-doctoral student, to use the inventive concept and engage in preparation to use prior to the university filing of a patent application.

Under these circumstances, who really bears the burden of proof of derivation? I understand that under the legislation, the prior user has to show and prove prior use.

But any time there is the threat of litigation or having to go through the steps of discovery, it is a real deterrent to investment. And this again diminishes the incentive I can offer to encourage commercialization.

In summary, I am not here to endorse prior user rights. I am concerned that prior user rights reward secrecy, are proned to abuse, and punish those acting in the spirit of our patent law. Prior user rights or the prior user defense too easily achieved or too broad in scope could damage our patent system and negatively impact the incentive to invest the publicly funded technologies and, hence, negatively impact bringing those forward to the public.

Judge Rich of the court of appeals has stated that the seemingly little advances are the bread and butter of progress and sometime turn out to be of much greater importance than first thought. The biggest contribution the patent system makes to progress is to induce a steady flow of contributions and to secure this continuous disclosure. This continuous disclosure is what universities are about. This is what university technology transfer is about and this is why I cannot endorse prior user rights.

I would be happy to answer any questions, and I thank you for consideration of this testimony.

Mr. HUGHES. Thank you.

[The prepared statement of Ms. Willey follows:]

Subcommittee on Intellectual Property and Judicial Administration

Statement by Teri F. Willey of Purdue Research Foundation

Opposing Prior User Rights - September 13, 1994

I respect that perceptions of prior user rights are couched in the perspective from which viewed. **That perspective differs substantially whether the viewer is a manufacturing entity, an individual, a university, federal laboratory or a small business. The emerging patent issues impacting the software industry add further complexities.**

I am here to represent a university perspective and to urge you, as you thoughtfully review those pertinent policy issues, not to forget the critical role universities play in new product development and in the economic health of this country.

As a university licensing professional, I have an obligation, as you do, to the public -- to U.S. taxpayers. My institution is a recipient of federal research funding and as a result we have a fiduciary responsibility to ensure that the public benefits from such support. Personally, I feel I have a social contract to make the benefits of federally funded research available to the public in a meaningful way...through traditional commercial channels. I take this stewardship seriously. That is why I'm here today.

New products and services are tangible outcomes of public supported research. **But, in order for commercially important research results to be meaningful, some "one" must invest in transforming the idea into a product, manufacture and distribute it. Only then does it become truly available to the public. The tool most commonly used to accomplish**

this is a patent license arrangement between the university and a for profit company. This license, and the guarantees of patent law, are the incentives the university can offer to encourage development of public funded research results. Prior user rights remove much of this incentive and discourage and undermine this type of commercialization collaboration.

The economic impact of university licensing efforts is real. These efforts result in products being distributed for the public benefit, support of university-industry research collaboration, and importantly the research and commercialization activities mean jobs for people who carry out the tasks of new product development, manufacturing and sales.

According to estimates by Dr. Stevens at the Dana Farber Cancer Institute in Boston, using the results of the 1993 Association of University Technology Managers Licensing Survey, there was over 45 billion dollars in product sales in 1993 attributable to non-profit technology transfer programs. Tax revenue to state, local and federal governments were estimated to be over 9 billion dollars. Applying standard economic models, non-profit research institutions helped to create or retain over 300,000 industrial jobs, which does not include jobs created by the universities and medical centers as a result of industrial funding.

U.S. patent law is important to university licensing efforts. Keep in mind that the word patent, is derived from the Latin *patere* meaning "to be open". The document which bears the seal of its author upon its face *litterae patents* or letters patent because it can be read without breaking the seal.

The Constitution (Article I, Section 8 Clause 8) provides that "the Congress shall have power to promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their respect their writings and discoveries..." Thus and inventor is granted the exclusive right to her writing or discovery for limited periods. In the case of a patent, the right granted is the right to exclude others from using the patented matter. Congress does not grant a monopoly to practice, but grants an exclusive right to exclude others from practicing that which was unknown to the public prior to the publication of the patent. It does not deprive the public of anything -- as do trade secrets. The inventor earns her right of exclusion by instructing the public how to practice what she seeks to protect.

The power given under this clause is not general. Congress is not empowered by the Constitution to pass laws for the benefit or protection of authors and inventors except as a means to "promote the progress of science and the useful arts.

Prior user rights favor the trade secret, which is an anathema to the underlying purpose of the patent system. When the choice is made to keep a valuable process a secret, that choice does nothing to advance the progress of the useful arts.

University practices are philosophically consistent with the patent system and unique in their contribution to the base of knowledge. This is accomplished through publication, even when patents are filed, and in the teaching and training of our work force.

Clearly prior user rights promote secrecy. This is impossible for a university, as a recipient of public funds it is not permissible and as an institution of higher education it is not practical. Research results are consistently and regularly published or otherwise disclosed to the public. Undergraduate, graduate, doctoral and post doctoral students participate in the research projects on a regular basis. From a practical standpoint, public institutions could not expect to hold trade secrets with students coming and going on to other universities and to industry. Even if we could keep a secret, prior user rights would have no value to universities (or any other non-manufacturing entity for that matter) since they are a "personal right" and would not be transferable to a licensee.

On a very practical basis, the right to exclude is the essential element in any patent licensing program and; therefore, in a university technology licensing program.

- If the university or its licensee cannot take action against a detected infringer that is practicing the licensed invention -- as a university licensing professional I loose incentives to offer my licensee to develop this invention for the public benefit.

- If that infringer can legally continue in its infringing activities without restriction or penalty -- I loose incentives to offer my licensee to develop this technology for the public good.

- If the university or our licensee must seek a determination of whether or not it is a situation of prior user rights or situation or derivation -- I loose incentives to offer my licensee to develop the product.

Secret prior user rights are an absolute defense against patent infringement liability. They constitute compulsory licensing but without compensation. In the face of the uncertainty of the right to exclude under a patent, the opportunity to license that patent is severely diminished. Early stage inventions, resulting from use of our public funds, are often risky investments anyway. Potential corporate licensees and venture capitalists are less like to advance the risk capital needed for the development, production and marketing of an invention where there is a significant chance that a powerful, unlicensed corporation could emerge as a competitor with no requirement to license and no requirement to pay royalties. Again, incentives are lost to develop these federally funded technologies for the public good.

Finally, with prior user rights, especially in regard to university inventions that are published well before a patent issues (let alone before it is filed when the grace period is used), the possibility of derivation is critical and it is real. Although secret prior use legislation calls for the prior users to have acted in good faith, meaning there should be no derivation from the inventor, the opportunity for mischief and abuse is large. This is particularly true where the invention resides in a university or other not-for-profit research institution. With the established university practice of publishing research results it is possible for a third party; who reads a publication, or hears a presentation, or reviews a poster at a scientific meeting, or interviews a graduate student or postdoc; to use the inventive concept. or even engage in preparation for use, prior to the university filing of a patent application. Under these circumstances, who bears the proof of derivation? Does this mean litigation, with its almost unlimited disclosure? The threat of costly and time-consuming litigation can be an economic weapon against a university. Clearly, this diminishes the incentive one can offer to encourage commercialization.

In summary, I believe that prior user rights are inequitable. Prior user rights would reward secrecy, allow abuse, and punish those acting in the spirit of our patent law. Prior user rights too easily achieved and too broad in scope could damage our patent system and negatively impact the incentive to invest in publicly funded research results and bring those results forward for the public benefit.

Judge Rich of the Court of Appeals for the Federal Circuit stated (In re Nelson et. al., 126 USPQ at 251):

> "In the very nature of things progress is made as a result of both the big and little contributions, mostly the latter We get a telephone or a triode -- in modern jargon a 'major breakthrough' -- only at rare intervals. The seemingly little advances are the bread and butter of progress and sometime turn out to be of much greater importance than at first thought. The biggest contribution the patent system makes to progress is to induce a steady flow of contributions and to secure their continuous disclosure."

This is what universities are about. This is what technology transfer is about. This is not an endorsement of secret prior user rights. Thank you for your thoughtful consideration of this complex policy issue.

Mr. HUGHES. And Mr. Newman.

STATEMENT OF ARNOLD L. NEWMAN, PRESIDENT, SYNEXUS CORP., WEST BETHESDA, MD

Mr. NEWMAN. Because Americans benefit greatly from the efforts of inventors, it is critical that patent policy be formulated to optimize the process of investigation and the incentive to invent.

I believe secrecy is antithetical to the process of invention and should not be endorsed or encouraged by adopting prior user rights. The full disclosure of an invention by a patent when it issues is what the inventor provides to society in exchange for the current 17-year exclusive right.

In contrast, a secret that is used to conceal an invention hides technology from both the public and the Government for an indefinite period of time. Proposed prior user rights set fundamentally conflicting policy on secrecy and would undermine the patent system. Currently, keeping an invention secret and not pursuing patent protection can be construed as suppression or concealment of an invention and can bar one from obtaining a patent on the invention.

It is contradictory that suppressing or concealing an invention, which under patent law would prevent someone from obtaining a patent, would be the means by which one would obtain even limited rights under someone else's patent. This is illogical, ambiguous, and fundamentally unfair.

Currently, the American patent system fosters information flow critical to invention, competition, and free enterprise. For example, sometimes other inventors can locate the boundaries of an invention disclosed in a patent and invent a new but different technology that competes in the same or additional markets. Particularly significant inventions when fully disclosed often spur the development of new products that complement, support, or relate to pioneering technology. Whole, new industries can develop from a single pioneering invention.

The polymerase chain reaction, for which Kary Mullis received the Nobel Prize, is a recent example. The secrecy associated with prior user rights would inhibit the free and easy access to information so essential to inventing.

Trade secret protection of an invention should be maintained, but as a circumscribed, second choice alternative to the patent system. Adopting prior user rights would remove much of the risk of keeping inventions secret, and this is not beneficial to society, which requires the open disclosure of patents to foster dynamic and continued innovation.

Granting prior user rights would remove the incentive for a prior user to challenge, through reexamination or other means, a patent perceived as protecting a trivial or obvious invention. This would diminish a built-in quality control feature of the present system.

Patent law already prescribes defensive measures for an inventor to protect his ability to use his invention without a patent, and this need for prior user rights is questionable. As examples, one could prevent others from patenting an invention by proving and, indeed, ensuring that the invention was known by others, offered for sale, or publicly used in this country, or described in a printed publication anywhere in the world.

Prior user rights would devalue patents. If a prior user is granted even limited rights to make, use or sell a patented invention, the patentee's right becomes nonexclusive. This decreases the value of the patent in the event of a license agreement or sale, and cripples the patentee's ability to negotiate a deal.

If prior user rights are provided, there will be more secrets. This will encourage competitors to waste resources by reverse engineering old inventions instead of trying to invent alternative technologies. American universities, which are engines of innovation unmatched elsewhere in the world, depend on technology transfer and licensing to commercialize their patents, and would be particularly vulnerable to prior user rights.

Prior user rights have an increased potential for complexity. For example, it is unclear what would constitute prior use, or what standard of documentation would be sufficient proof of prior user. Interference proceedings between patentees and alleged prior users are also conceivable. Complex and uncertain, prior user rights would increase costly litigation and pose an additional burden on the courts.

Some argue prior user rights would protect against patented inventions perceived as ridiculously broad, trivial, obvious, or well-known. Rather than adopting prior user rights as a loophole defense against bad patents, the public would be better served by facilitating the difficult job of patent examination and hence the quality of patents.

Finally, prior user rights are often proposed as a part of a larger attempt to "harmonize" our patent system with those of foreign countries. Historically, American inventiveness has been qualitatively different from that of other countries and, indeed, today most breakthroughs continue to come from this country.

The current patent system reflects the American tradition of rewarding the first in a fair and open endeavor, whether it be the discovery of gold, the invention of the phonograph, or the first flight across the Atlantic. Indeed, Lindbergh would not have become quite so celebrated if his flight were taken in secret. To practice a technology in secret, only to reveal it when someone else gets a patent, is against our culture and tradition.

Our economy requires growth and change, and this is stimulated in part by a patent system that rewards inventors in exchange for full and open disclosure of technological innovations. The delicate and dynamic balance existing between the greater good of a free industrial society that benefits economically, socially, and culturally from technological innovation, and the property rights of the inventor is currently maintained by our patent system, which has evolved according to our unique culture. This system works well and should not be diluted or unbalanced by prior user rights. Thank you.

Mr. HUGHES. Thank you very much, Mr. Newman.

[The prepared statement of Mr. Newman follows:]

SYNEXUS CORPORATION
P. O. Box 341302
West Bethesda, MD 20827

**STATEMENT OF ARNOLD L. NEWMAN, PRESIDENT
SYNEXUS CORPORATION**

BEFORE THE

SUBCOMMITTEE ON INTELLECTUAL PROPERTY AND JUDICIAL ADMINISTRATION

OF THE

HOUSE COMMITTEE ON THE JUDICIARY

ON

PRIOR USER RIGHTS

SEPTEMBER 13, 1994

Technology Assessment • Technology Transfer • Technology Development

Phone (301) 365-0148 **Fax (301) 365-0149**

Mr. Chairman and Members of the Subcommittee:

My name is Arnold Newman. As an independent inventor, I have approximately twenty U.S. and foreign patents, half of which have been licensed. Since leaving The Johns Hopkins University Applied Physics Laboratory in 1986, I have founded or cofounded four companies. Currently, as President of Synexus Corporation, I am involved in the development, licensing, and transfer of my own technology and that of others.

I am pleased to testify today on prior user rights, which I oppose.

Because American society benefits greatly from the creative efforts of inventors, it is critical that patent policy be formulated first and foremost to optimize the process of invention. That is, the conception of an invention and its reduction to practice should be facilitated by the patent system. As currently formulated, the first-to-invent patent system provides the first, diligent inventor with protection from the time of conception, and is an incentive to actually make the invention and test it. This first-to-invent system encourages the diligent inventor to complete an invention before filing a patent application. It discourages the filing of premature and potentially non-enabling patent applications. Both inventions and patent applications are better when written after the prototype is made or the process tested, and laboratory data are available. The secrecy attendant to this process, and to the time of patent prosecution, is under the inventor's control, and is maintained by the patent office after the patent application is filed to protect the potentially imminent property rights of the inventor. The secrecy of a pending application that eventually issues as a patent is temporary, and the invention is fully disclosed to the patent office during the examination process.

Many inventions are disclosed before the patent issues because inventors often feel sufficiently protected under the first-to-invent system and by the fact of a pending patent application. Thus, the public learns of the invention, at the latest, after a patent issues, at which time a full disclosure of how to make and use the invention becomes part of the public record freely available to all. The full disclosure of an invention by a patent is what the inventor provides to society in exchange for the current 17 year exclusive right. The secrecy of pending patent applications is very different from that of a trade secret or a secret that is used to suppress or conceal an invention, where technology is kept from both the public and the government for an indefinite period of time.

The issue of prior user rights is very complex. I sympathize with those who have not pursued patent protection for technology critical to their businesses, whether through ignorance, lack of experience, or bad luck. However, I am compelled by experience and philosophy to reject prior user rights.

Proposed prior user rights would undermine the patent system. First, it sets fundamentally conflicting policy with regard to secrecy. Current patent law dictates that an invention be kept secret by the Patent Office after an application for a patent is filed, until the time when the patent is granted. Also, at present, the very act of keeping an invention secret and not pursuing patent protection can be construed as suppression or concealment of an invention (35 USC §102(g)) and can bar one from obtaining a patent on the invention. It is contradictory that the act of suppressing or concealing an invention, which under patent law would prevent someone from obtaining a patent, would be the very means by which one would obtain even limited rights to make, use, or sell the invention of someone else's patent under prior user rights. This is illogical, ambiguous, and fundamentally unfair.

The secrecy associated with prior user rights would also inhibit the free and easy access to information so absolutely essential to the process of invention. Information is the fuel of invention because it provides the components of an invention, which when combined by an inventor, become greater than the sum of its parts. Information is so important to the process that its suppression or concealment is antithetical to innovation. Sequestration of information causes technological stagnation because it inhibits inventors and also because it prevents scientists from efficiently doing research.

As currently structured, the American patent system fosters information flow critical to invention, competition, and free enterprise by providing a public record of invention and technology. For example, other inventors can locate the boundaries of an invention defined in a patent and invent around it to produce new technology designed to compete in the same or additional markets. There are often two, three, or more distinct ways to solve the same problem. I have considerable experience in the field of chemical sensors and chemical analysis and have found that it is usually possible to accomplish the same chemical measurement with three completely different instruments. Another example of the importance of open disclosure of technology is that particularly significant inventions often spur the development of new products that complement, support, or relate to the pioneering technology. The polymerase chain reaction (PCR), invented by Kary Mullis for which he received the Nobel Prize, is an elegant, beautiful, and critically important invention that has elicited further inventions by others of a wide variety of reagents, instruments, and improvements. This would not have occurred were PCR not fully disclosed.

While I oppose the increased secrecy and concealment of information attendant to prior user rights, I believe that the practice of trade secret protection of intellectual property provides a circumscribed, legitimate process available to industry that should be maintained in its present form. With trade secret protection, one weighs the benefit and cost of carefully maintaining a technological trade secret potentially indefinitely against the risk of someone else obtaining a patent on the technology. This should be an informed decision, and, under the current system, one would not logically choose trade secret protection for a technology critical to the survival of one's company. Protecting technology critical to a company's economic health is best done through options available under patent law. Obviously one can obtain a patent. Should one choose not to pursue patent protection, current provisions of patent law can be used to prevent others from obtaining a patent. For example, publishing a full description of an invention or using an invention openly in public are defensive actions currently available that can be used to prevent others from obtaining a patent on an invention.

Granting prior user rights would remove the incentive for a prior user to challenge a patent (e.g., reexamination) perceived as protecting a trivial or obvious invention, and would lead to the loss of this built-in quality control feature of the present system. Another way in which prior user rights would undermine the patent system is that it would fundamentally devalue patents. With prior user rights, after an invention is patented by another, the prior user then gets benefit of that patent for an additional 17 years as perhaps the only entity, aside from the patentee, to make, use, or sell the invention. This devalues the patent because the patentee's right becomes nonexclusive. It decreases the value of the patent in the event of a license agreement or sale and cripples the patentee's ability to negotiate a deal.

If prior user rights are provided under intellectual property law, I believe that inventors and entrepreneurs will use them. This would harm the patent system and the negative consequences should be considered. More technology will be used in secret because there will be less risk to doing so. More inventions will be practiced secretly that might otherwise be disclosed in patents and technical literature. This will encourage competitors to waste resources by engaging in reverse engineering instead of trying to invent alternative technologies. American universities, which are veritable engines of innovation unmatched elsewhere in the world, would be at a disadvantage because, not manufacturing or practicing technology in the commercial world and rarely developing technology beyond prototype and demonstration stage, they would be particularly vulnerable to prior user rights. They depend on technology transfer and licensing to commercialize their technology.

A potential adverse consequence of adoption of prior user rights is an increased possibility for complexity and even fraud. It is not clear what would constitute prior use. Is the use of a technology sporadically over a period of several years prior use, or must a company use a technology continuously? What documentation would be sufficient proof of prior use? Must it be to the same standard required by patent law to prove diligence? One can envision interference proceedings between patentees and alleged prior users. Certain "prior users" might choose to change course and elect to pursue patent coverage. This would require a determination as to whether the invention was suppressed or concealed. The uncertainty and complexity of prior user rights would increase costly litigation and pose an additional burden on the courts.

Having discussed the potential disadvantages of prior user rights, what are the proposed advantages, and are prior user rights necessary to gain these advantages? Prior user rights have been advocated as a way to protect a prior user's right to make, use, or sell an invention should he not patent it. The current system provides a number of ways for an inventor to protect his ability to use his invention, however, and the need for prior user rights is not clearly evident. For example, if one chooses not to patent an invention, one does not have to practice it in secret. Current patent law prescribes defensive measures for preventing others from obtaining a patent on the same invention. One can take action to prove and, indeed, ensure, that the invention was known by others in this country. One can describe the invention in a printed publication. As an example, IBM publishes a technical disclosure bulletin distributed to various libraries that describes inventions in enough detail to prevent others from obtaining patents on those inventions. One can also publicly use or sell the invention in this country. Additionally, reexamination procedures allow for the consideration of facts not applied during the original examination. Finally, litigation can be used to invalidate a patent.

Prior user rights have also been advocated as a way to fix certain "defects" some perceive in the current system, specifically to counterbalance the inappropriate granting of patents for technology that has already been in use. There has recently been a lot of industry hysteria and press coverage about patents that have issued, particularly in the software field, that too many consider to be ridiculously broad, if not invalid. These patents cover technology that many consider to be publicly known. I believe that some remedies already exist in the patent system to fix such mistakes, and others specific to the problems may be devised. Patent examiners have a very difficult job, and they operate under a lot of pressure to be productive and examine as many applications as possible. There is not enough time to perform adequate patent searches, particularly in such fields of explosive growth as software and biotechnology, where most of the disclosures are published in the non-patent technical literature. Indeed, because most patent examiners do not actually practice technology, it can often be difficult for them to know what constitutes obviousness. Because this is often determined according to the abilities of those with ordinary skill in the art, in a fast developing technical field, practitioners in industry are in the best position to know the prior art and judge obviousness. As an electrical engineer with many years of experience, I have often come upon patents in the electronic arts disclosing technology or techniques that struck me as either trivial, obvious, or both, representing methods that any experienced engineer would know and use. Rather than pursuing prior user rights, more good would come from developing administrative policy that facilitates the job of patent examination and thus the quality of issued patents.

The following suggestions are specific to the problem of recognizing obviousness and identifying the appropriate prior art. There should be more technical forums between the patent office and industry where significant trends in technology can be discussed. There is a need for additional technical information experts, perhaps even ad hoc reviewers, to assist examiners in searching the non-patent technical literature which examiners, particularly in fast developing fields, should be strongly encouraged to do. Librarians in corporations should be invited to help in updating literature available to patent examiners.

Finally, it is often proposed that we adopt prior user rights as part of a larger attempt to "harmonize" our patent system with those of foreign countries. This proposal ignores the history of American industrial development. It is logical that our patent system is unique and adapted to our culture, because we are different from other countries. Our population largely derives from a self-selected group of adventurous and pioneering immigrants who left their native lands for a new and dangerous nation. The disproportionate percentage of American risk takers has affected our culture to the extent that risk-taking is admired and rewarded. The need for constant, dynamic change is programmed into our society and this provides American inventors with new problems to solve and needs to satisfy. Since colonial times, American inventiveness has been qualitatively different from that of other countries. Today, most technological breakthroughs continue to come from this country. The current patent system reflects the American tradition of rewarding the first in a fair and open endeavor, whether it be in the discovery of gold, the invention of the phonograph, or the first flight across the Atlantic. Indeed, Lindbergh would not have been quite so celebrated if his flight were taken in secret. To practice a technology in secret, only to reveal it when someone else gets a patent, is counter to our culture and tradition.

The American patent system in its current form has proven empirically to be too successful and too critical to our economic health to be bargained away as a concession during negotiations with foreign countries. Unfortunately, patent policy makers currently appear to favor the opinions of foreign governments and multinational corporations over the needs of American inventors, whose perspectives and insights are largely absent in the debate.

Our economy requires growth and change, and this is stimulated in part by a patent system that rewards inventors in exchange for full and open disclosure of technological innovations. The delicate and dynamic balance existing between the greater good of a free industrial society that benefits economically, socially, and culturally from technological innovation, and the property rights of the inventor is currently maintained by our patent system, which has evolved according to our unique culture. This system works well and should not be diluted or unbalanced by prior user rights.

Mr. HUGHES. First of all, there are certain industries in which patents simply were not approved until court decisions broadened the reach of the patent system. Doesn't this prior inability to obtain patents justify some special type of protection now for those industries, Mr. Moy?

Mr. MOY. I would want to take a look at those industries very carefully. My own personal view is basically anything that can be learned through reverse engineering is of public use as that concept is understood in 102(a) and 102(b). I believe that you are referring probably to the software industry, and while I don't have a background in software technology, rather mechanical technology, my understanding is that large amounts of the technology that the software industry is worried about being locked out of, in fact, is capable of being reversed engineered through ordinary skills in the art. So I think, frankly, by clarifying the scope of sections 102(a) and 102(b) much of their worries would go away.

I would want to take a look, then, and see what remains after that. I agree that if there is a substantial amount that remains after that, there would be a risk.

Mr. HUGHES. Well, Professor, I gather you were wrestling with a problem of what it really is, a trade secret. One of your suggestions is that we should perhaps modify section 102(g) as a way to deal with those situations where instead of it being what we generally refer to as a trade secret, it was perhaps an incremental improvement in a process over a period of time which occurred in the workplace. And by any standard that process, patented by a subsequent patentee, is taking advantage of a technology that has existed for as much as 20 years, in Mr. Budinger's case. What is the difference, whether we modify 102(g) or whether or not we classify it as a prior user right?

Mr. MOY. The difficulty I have with the scenario—

Mr. HUGHES. If it is a limited prior user right.

Mr. MOY. Yes, the difficulty I have of broadly enacting prior user rights is this: The case law, which is admittedly somewhat jumbled in this area, is that technology that is restricted from public dissemination through purposeful attempts to keep it private cannot be relied upon as prior art. And I think that probably is justified. But I think we can segregate those situations away from situations where someone on the shop floor has simply put technology into use without thought of whether it would become public or not, that is, without consciously calculating the need for it to be kept secret.

What we are interested in doing, I think, is biasing people's decisions, when they are looking at trade secrecy or patenting, toward patenting, and away from trade secrecy. If we have someone who is not even considering the matter, they are not really the people we are looking at.

Mr. HUGHES. But the problem is that a lot of small industries, in particular, do not, in fact, file for patents because of the cost of them. And the question is, getting back to some of Mr. Newman's testimony, is are we promoting the sciences and useful arts by encouraging small firms to innovate? It seems to me that is the point that the Commissioner of Patents and Trademarks made this morning.

Are we not fulfilling really the mission of the constitutional provision by encouraging small firms to innovate, in incremental fashion, and are we not penalizing them if we do not protect them? If they are the ones that for 20 years developed a particular technique, which they did not characterize, did not necessarily treat as a trade secret, it just happened to be the way they became efficient over a period of time, and are we not really promoting the sciences and the useful arts by encouraging that? And are we not penalizing those that innovate—in fact, say some smart guy coming in 20 years later that sees that his competitor has a pretty good technique, did not take him much difficulty to find out why he was so efficient and now they go in and they basically file a patent application and take advantage of basically the innovation of somebody who invented that technique.

Mr. MOY. I see your point, and I think we are in agreement on a very basic point. Like a lot of patent attorneys, I believe most inventions probably stay outside the patent system and do not become part of a patent application. That is probably a good thing, not a bad thing. We are probably on the same footing there.

What I would point out is that the patent system, if properly used, does not really dissuade these people from continuing the course of activities that you are talking about. In fact, the fact pattern you have come up with, that is where someone else can perceive the innovators' technology, could have obtained the technology through the current techniques. That is enough to inject the technology into the public domain. And, in that case, not only does the technology become something that can be practiced without worry of patent liability, but anything that is obvious over it can be practiced as well.

So I would say that, if somebody is in their plant making incremental developments and worried about whether or not they are going to be held liable for a patent infringement, "Look, the patent system already has a mechanism for you. Things that are obvious over the prior art cannot be patented. So if you are doing an incremental sort of change, you have already a safety mechanism in the present law." You see? I think that will take care of most of the cases.

Mr. HUGHES. Mr. Newman, you were about to comment.

Mr. NEWMAN. Well, first, I would like to say I have trouble with the term "incremental improvements." And the reason is because it is a relative—it has to do with perception. If a small company is making incremental improvements, that if they are by somebody else's patent barred from using them, then those are pretty substantial technologies for them. And if it puts their company at risk not to be able to practice those improvements, then that in and of itself is criteria to use the patent system or if——

Mr. HUGHES. But at what point do you do that? Here you are, you are a small industrialist and you encourage your work force to try to improve your techniques. You provide bonuses, rewards for them to do that over a period of time; you develop a process that is fairly efficient. When do you decide that that is worth investing in the kind of money you have to invest in to get a patent at what point? That is the point a lot of industrialists face, I would think.

Mr. NEWMAN. It is a matter of judgment, and it is a judgment that people are getting better at making because of what is going on today and also with the globalization of the economy. A lot of people have made mistakes and they can be very upset about that and want to make changes in patent law, but other people are becoming very sophisticated about it and developing an experiential base upon which to make judgments as to when to patent.

What one does in business in a situation where you are not sure whether you want to get a patent or not is you look and see if there are alternative ways available to do the same—to make the same product. It is a whole series of decisions that one has to make, and I think it is very important that people become sophisticated in this way.

You are beginning to see that just looking at the software industry, the number of patents issuing in software, if you go to the stacks in the Patent Office, maybe there would be 20 or 40 bundles of patents issued just in the last 3 years.

Mr. HUGHES. There are all kinds of advantages in filing a patent application. I mean, it is preferable. It provides a monopoly; it provides protection for perhaps as much as 20 years, depending upon what happens with GATT. But you know, the fundamental question is how do you confront the argument that a prior user may really be the first to invent the product or process and is therefore entitled to protection under the Constitution?

Mr. NEWMAN. If the prior user is in effect?

Mr. HUGHES. If you have somebody that basically has developed an innovative technique, a process, and for various reasons did not feel that he could afford or perhaps it happened over a period of time and he did not in fact file a patent application, but he is the one that created the process, what do you say to the argument that the Constitution should protect him? He is the first inventor.

Mr. NEWMAN. There are alternatives available to him. He can patent.

Mr. HUGHES. Let us speak about what the Constitution—the Constitution is trying to encourage innovation, promote the useful arts and sciences. Why is he not doing that?

Now, Mr. Budinger was not necessarily engaging in providing a trade secret for his technology. But he contributed. Well, his competitor found out very easily in time basically what their techniques were and why he was so efficient. And there are folks that do not believe that it is necessarily a trade secret. This happened to be a process they developed over a period of time. Why should we not, as the policymaking body in this country, protect that inventor?

Forget the patent process by granting a monopoly, why should we not protect any innovator, anybody that invents something that promotes the useful arts and sciences in this country?

Mr. MOY. I can take that question.

Mr. HUGHES. Sure, Professor.

Mr. MOY. Well, I think you always have to keep in mind that granting patents is an exception to the general rule, which runs throughout our social fabric and that is that generally speaking open competition is preferable to an absence of competition.

Mr. HUGHES. But, Professor, the folks in this country benefit from his product. The people around the world benefit from his product.

Mr. MOY. Absolutely.

Mr. HUGHES. He did not file a patent application but what he did was he basically innovated and he developed this process and he became very competitive. He competed with firms around the world who take advantage of prior user rights. He cannot in this country because we do not have prior user rights. Why is he not entitled to protection?

Mr. MOY. The question is this: The question that any society has to ask, including our own, is at what point do the social benefits of protecting someone like that outweigh the social costs. And the balance that is struck in the patent system as it exists now is that when the event that is being sought to be protected is novel, unobvious, and accompanied by a public disclosure from the initial date, then the social costs are low enough and the social benefits are high enough to justify this intrusion into the competitive marketplace. And the reason why I would say that a trade secret user ought not to be protected is because, while we may have a technology that is novel and unobvious, it is not being associated with the public disclosure as well. The social costs are therefore higher and it may very well be that it is a deal that the public ought not to strike. That is my sense of what the patent system currently does, and I think by giving prior user rights to someone like that, you would be in the process of recasting a basic fundamental judgment that the patent system embodies.

Now certainly it is possible to accommodate trade secret users, for example, by changing the suppression and concealment language in section 102(g). Certainly that can be done; certainly it is within the power of this body to do that and certainly I think it is an arguable question as to whether it ought to be done or not.

But the point that cannot be escaped is that making such a change would cause a fundamental realignment of what the patent system is currently doing. It is jumping in and upsetting the competitive marketplace for purpose of trying to foster trade secret innovation—that is really the problem that I have.

What I would do is first try something that is less intrusive to solve these problems. And if I did, in fact, make the fundamental intrusion that is under discussion here, I would do it only after significant study.

Mr. HUGHES. Ms. Willey, I just detect that you would prefer not to have any prior user statute, but if you have to have one, this is probably as limited as you are going to get. Am I reading you correctly?

Ms. WILLEY. In fact, that is the position that the Association of University Technology Managers have taken.

Mr. HUGHES. Because you could take a lot more than what basically is in this legislation.

Ms. WILLEY. Absolutely. The position is that we have agreed not to openly oppose this version. We accept that something has changed, and these are the issues of NAFTA and GATT, global trade issues which may shift the balance in cost and benefit of a prior user right. We recognize this change, nevertheless, as universities, and not-for-profit organizations and a place that cannot keep a secret, prior user rights have no benefit to us.

Mr. HUGHES. You have to invest in your university system.

Ms. WILLEY. We cannot maintain a trade secret. We have students coming and going and being hired away and faculty publishing their work.

Mr. HUGHES. I hope you will keep my grades secret from a while back.

Ms. WILLEY. I will be happy to keep your grades secret. As to our position, we accept that as we enter the global marketplace and weigh these costs and benefits that some form of prior user rights will most likely be implemented. And, if they are, we want to make sure the university's role in new product development is taken into consideration.

Mr. HUGHES. I think you are omniscient. I think you are probably right.

Ms. WILLEY. We are trying to be realistic. We have to be idealistic and realistic at the same time. We make decisions every day whether to expend money on patent applications. They are very expensive. If we are to disseminate knowledge through the use of patents, we do so when we think we can capture value with the intellectual property that is created.

Mr. HUGHES. Professor Moy, if you had a legitimate prior user who had a licensed process for use of a third party under a secrecy agreement, would that third party be able to claim a prior user defense under the Senate legislation, in your judgment?

Mr. MOY. Under the Senate—let me make sure I have the fact pattern correct here. We have a legitimate prior user, someone who would be a prior——

Mr. HUGHES. For use to a third party under a secrecy agreement. Would that third party be able to claim a prior user defense under the Senate bill?

Mr. MOY. Had they achieved the status by the priority date of the applicant?

Mr. HUGHES. Yes.

Mr. MOY. My understanding of that legislation is that this person probably would have such a right. I am not positive but I believe that they would.

We are a little bit fortunate in patent law, because our statute tends not to resemble the Tax Code in too many places, but as the amendments are layered on the 1952 act, we have a tendency to look more and more like it. The Senate bill is not an easy statutory enactment to wade your way through, but that is my sense of it.

Mr. HUGHES. Ms. Willey has already addressed this, but I want to hear from you, Mr. Newman. Other countries protect their domestic industries from prior user rights. I think most of the industrialized world has prior user rights; most of our major traders, all of our major trading partners. I cannot think of one exception. In essence, an additional protection against foreign patents. The United States does not provide such protection. Does that not put our industries at a competitive disadvantage?

Mr. NEWMAN. In some ways, yes. We also are different in the sense that we are first to invent as well and they are all first to file. Aside from, I guess, the Philippines and Jordan.

Mr. HUGHES. Well, that is for now.

Mr. NEWMAN. Right.

Mr. HUGHES. That is changing. I don't suspect that prior user rights is going to change around the world.

Mr. NEWMAN. I think the argument for prior user rights in a first-to-file country is perhaps stronger. But other than that, I would say that we also are a fundamentally unique nation industrially and one could say, for example, as a nation of immigrants, we have particularly attracted risk takers.

Mr. HUGHES. Do you think we will be harmonizing our laws with the rest of the world?

Mr. NEWMAN. I think that there is this—at the present time, there seems to be a lot of policymakers, people in government, who are pushing for that. I think there is a lot of pressure from multinational and large companies. But I think that smaller inventors see the first to invent as a means to test inventions, try them out before filing a premature patent application, and I think that first to invent versus first to file will be the major aspect in harmonization.

Prior user rights, you know, seem to be proposed by people who also mention the fact that they exist overseas, and then there are some other issues relating to harmonization too. But I think that the harmonization issue is driven by international trade. And the consideration of the policy for harmonization is driven by an international perspective that sometimes does not balance the needs and the unusual ways in which we tend to invent. We tend to be particularly good at conception and prototyping.

There has been, over the years, a number of people who have said we are not perhaps as good at followthrough. So perhaps maybe conception and the due diligent reduction of practices is something that we should be concentrating on.

My concern about——

Mr. HUGHES. We also have to be realists. Will we not have to be more and more in a global economy? Won't we have to look to protect our industries vis-a-vis what other countries are doing? How can a company remain competitive in this country if in fact other countries are playing by different rules that give them a competitive advantage?

Mr. NEWMAN. I think it is important in negotiating to set forth our side of the story as well. And I do not see that we are getting— I do not see that our perspective is respected internationally and I think our perspective is really something that has evolved over 200 years and nobody can argue with our success.

So how do you retain the inventiveness of Americans and protect it at the same time, that you do not dilute it by, for example, requiring them to file patent applications before they are actually finished with the invention.

Mr. HUGHES. Well, 200 years ago, Mr. Newman, most of our market was a domestic market. That market has changed considerably. Much of our market is a global market. And the beauty about our Constitution and our system of laws is that they can adapt by change. And harmonization, I think, is inevitable.

Mr. NEWMAN. I think it is probably going to happen the way people predict. I think so. But my concern is that the features of our system that have really been very good for us, and not only 200 years ago, but still today, be retained in some way that American inventors are not being forced to adapt to systems that may have been developed for very different reasons and, in fact, end up protecting not the small companies, not the most innovative aspects of society, but the strongest.

The thing with prior user rights that is often heard about, is the small inventor, the smaller companies maintaining their ability to practice a particular invention. As a small inventor, I am particularly worried about a large company asserting prior user rights against me. If you are just starting to manufacture something under a patent or patent pending, and later on a very, very large company asserts prior user rights, I mean it could be pretty difficult for you. So it works both ways.

Mr. HUGHES. They would have to establish that they basically had openly at that point invented that particular technology and they would have to establish that by a preponderance of evidence.

Mr. NEWMAN. They would.

Mr. HUGHES. They would have to establish they were the first inventor. Isn't that what our country is all about, trying to basically reward the inventor?

Mr. NEWMAN. I think the argument about balancing the patent system between the need for disclosure and against keeping technology secret is a very important issue that has to be brought into that part of the equation. Because I will tell you that the process of invention is totally dependent on the availability of information. And when you have people actually going to the Patent Office and getting state-of-the-art searches to try to figure out other ways that do not infringe a patent but also would address the same lucrative markets——

Mr. HUGHES. Well, I have enjoyed this dialogue and I think it has been a very helpful panel and I appreciate your contributions here today.

It is a very interesting issue and, frankly, I approached it the same way you did initially, and my initial visceral reaction is precisely what I have heard from this panel and I might say from the Commissioner of Patents, but on balance there is, I think there is a legitimate problem, a legitimate need to try to do something about a basic inequity that exists for prior users, and I am also a realist, Ms. Willey, and I see what has happened internationally also and, frankly, I would be happy to hear from you on how we could perhaps make it any more protective and limited than the Senate bill is today.

I have heard some suggestions today and the record will remain open for a period of 10 days in the event you want to submit anything additional for the record. Thank you very much.

That concludes the testimony for today and the subcommittee stands adjourned.

[Whereupon, at 5:10 p.m., the subcommittee adjourned.]

APPENDIXES

APPENDIX 1.—H.R. 4978, A BILL TO AMEND TITLE 35, UNITED STATES CODE, TO HARMONIZE THE UNITED STATES PATENT SYSTEM WITH FOREIGN PATENT SYSTEMS, CH. 28. SEC. 1, § 273, 102D CONG., 2D SESS.

*Partial bill

102D CONGRESS
2D SESSION

H. R. 4978

To amend title 35, United States Code, to harmonize the United States patent system with foreign patent systems.

IN THE HOUSE OF REPRESENTATIVES

APRIL 9, 1992

Mr. HUGHES (for himself and Mr. MOORHEAD) introduced the following bill; which was referred to the Committee on the Judiciary

A BILL

To amend title 35, United States Code, to harmonize the United States patent system with foreign patent systems.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; REFERENCE.

(a) SHORT TITLE.—This Act may be cited as the "Patent System Harmonization Act of 1992".

(b) REFERENCE.—Except as expressly provided otherwise, whenever in this Act a section or other provision is amended or repealed, such amendment or repeal shall be considered to be made to that section or other provision of title 35, United States Code.

"(B) was on sale in the United States more than one year before the filing date of the application for patent.

"(b) GRACE PERIOD.—Notwithstanding the provisions of subsection (a), subject matter disclosed in the prior art not more than one year preceding the filing date or priority date of the application for patent shall not affect novelty or nonobviousness under this section whenever it results from a disclosure of information obtained directly or indirectly from an inventor named in the application.".

(2) The table of sections at the beginning of chapter 10 is amended by adding at the end the following:

"106. Conditions for patentability; first to fill novelty, nonobviousness, senior priority, and right to patent.".

(b) INFRINGEMENT.—(1) Chapter 28 is amended by adding at the end the following:

"§ 273. Rights based on prior use

"(a) IN GENERAL.—A person shall not be liable as an infringer under a patent granted to another with respect to any subject matter claimed in the patent that such person has, acting in good faith, commercially used or commercially sold in the United States, or has made effective and serious preparation therefor in the United States, before the filing date or priority date of the application for patent.

"(b) QUALIFICATIONS.—(1) The rights based on prior use under this section are personal and shall not be subject to assignment or transfer to any other person or persons except in connection with the assignment or transfer of the entire business or enterprise to which the rights relate.

"(2) A person shall be deemed to have acted in good faith in establishing rights under this section if the subject matter has not been derived from the inventor.".

(2) The table of sections at the beginning of chapter 28 is amended by adding at the end the following:

"273. Rights based on prior use.".

SEC. 4. APPLICATION FOR PATENT.

(a) BENEFIT OF EARLIER APPLICATION WITHIN 1 YEAR; RIGHT OF PRIORITY.—Section 119 is amended to read as follows:

"§ 119. Benefit of earlier application within 1 year; right of priority

"(a) PRIORITY RIGHT IN PRIOR APPLICATIONS.—An application for patent for an invention filed in the United States by an applicant who has, or whose legal representatives, agents, or assigns have, previously regularly filed an application for a patent for the same invention in the United States or a foreign country, if such foreign country affords similar privileges in the case of applications filed in the United States or to citizens of the United

APPENDIX 2.—S. 2272, A BILL TO AMEND CHAPTER 28 OF TITLE 35, UNITED STATES CODE, TO PROVIDE A DEFENSE TO PATENT INFRINGEMENT BASED ON PRIOR USE BY CERTAIN PERSONS, AND FOR OTHER PURPOSES

103D CONGRESS
2D SESSION

S. 2272

To amend chapter 28 of title 35, United States Code, to provide a defense to patent infringement based on prior use by certain persons, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY 1 (legislative day, JUNE 7), 1994

Mr. DECONCINI (for himself and Mr. BIDEN) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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A BILL

To amend chapter 28 of title 35, United States Code, to provide a defense to patent infringement based on prior use by certain persons, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Patent Prior User Rights Act of 1994".

SEC. 2. DEFENSE TO PATENT INFRINGEMENT BASED ON PRIOR USE.

(a) IN GENERAL.—Chapter 28 of title 35, United States Code, is amended by adding at the end thereof the following new section:

"§ 273. Rights based on prior use; defense to infringement

"(a) DEFINITIONS.—For purposes of this section, the term—

"(1) 'commercially used' means the use in interstate or intrastate commerce, including the use of processes, equipment, tooling, and intermediate materials in the design, testing or production of commercial products whether or not such processes, equipment, tooling, and intermediate materials are normally accessible, available, or otherwise known to the public;

"(2) 'effective and serious preparation' means that a person, in the United States, has—

"(A) reduced to practice the subject matter for which rights based on prior use are claimed; and

"(B) made serious plans, and a substantial investment or much of the investment necessary for the subject matter to be commercially used; and

"(3) 'critical date' means the filing date or the priority date, whichever occurs first, of the application for patent.

"(b) IN GENERAL.—A person shall not be liable as an infringer under a patent granted to another with respect to any subject matter claimed in the patent that such person had, acting in good faith, commercially used in the United States or made effective and serious preparation therefor in the United States, before the critical date.

"(c) LIMITATION OF DEFENSE.—Subject to subsection (d), rights based on prior use under this section extend only to the claimed invention that the person claiming rights based on prior use was in possession of prior to the critical date.

"(d) CERTAIN VARIATIONS AND IMPROVEMENTS NOT AN INFRINGEMENT.—The rights based on prior use under this section shall include the right to make and use variations or improvements, including variations in the quantity or volume of such use. Such variations or improvements may not infringe additional claims of the patent.

"(e) QUALIFICATIONS.—(1) The rights based on prior use under this section are personal and shall not be licensed or assigned or transferred to another except in connection with the assignment or transfer of the entire business or enterprise to which the rights relate.

"(2) A person may not claim rights based on prior use under this section if the activity under which such person claims the rights was—

"(A) based on information obtained or derived from the patentee or those in privity with the patentee; or

"(B) abandoned on or after the critical date, except that for abandonment which occurs after the critical date, rights based on prior use may be used as a defense to infringement for that period of activity which occurred prior to abandonment if such activity would otherwise, in the absence of abandonment, have been allowed under this section.

"(3) The rights based on prior use under this section are not a general license under all claims of the patent, but are restricted in scope to cover only that subject matter claimed in the patent that has been commercially used, or for which there has been effective and serious preparation, in the United States, before the critical date.

"(f) BURDEN OF PROOF.—In any action in which a person claims a defense to infringement under this section the burden of proof for establishing the defense shall be on the person claiming rights based on prior use.".

(b) TECHNICAL AND CONFORMING AMENDMENT.—The table of sections for chapter 28 of title 35, United States Code, is amended by adding at the end thereof the following:

"273. Rights based on prior use; defense to infringement.".

SEC. 3. EFFECTIVE DATE.

The provisions of this Act and the amendments made by this Act shall take effect on the date of the enactment of this Act.

○

APPENDIX 3.—STATEMENT OF SOFTWARE INDUSTRY COALITION

Software Industry Coalition

Submission for the record in the hearings on:

PRIOR USER RIGHTS

BEFORE THE

Subcommittee on
Intellectual Property and Judicial Administration
of the House of Representatives

Summary of Statement

- **Software Industry Coalition strongly supports Patent Prior User Rights**
- **Rights benefit both large and small US Industries**
- **Rights harmonize US Law with existing international law**
- **Rights strike a good balance between trade secret law and patent law**
- **Rights require clarification to insure utility for software developers**

Software Industry Coalition

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The Software Industry Coalition is a non-profit association representing many of the most innovative corporations in the Silicon Valley which own patents, trademarks, copyrights and trade secrets. Members of the Coalition include such companies as Borland, Informix, Lawrence Livermore National Laboratory, Silicon Graphics, Sunsoft and Taligent.

Software Industry Coalition Support for Patent Prior User Rights

The Software Industry Coalition strongly supports patent prior user rights as a welcome addition and improvement to US Patent and trade secret laws. The addition of these rights will benefit both large and small US industries, including the fast growing software industry. The rights harmonize US Law with existing international law and strike a good balance between trade secret and patent law. However, for prior user rights to address many of the concerns that developers raised at the recent hearings on software patents that conducted by Commissioner Lehman in San Jose and Arlington, appropriate clarification of downstream user rights must be provided that were not included in the Senate Bill S.2272.

The Software Industry Coalition members rely on patent protection to protect important technology and are forced to patent many inventions to avoid later confrontations with others who might obtain patents on these marginal inventions. Under current law, an independent innovator can market an inventive product without seeking patent protection, but it leaves her at risk even if a clearance is performed of all issued patents. The prior invention of another party can still be filed for up to a year after the first public disclosure of the invention and can subsequently mature into a valid patent which could completely block subsequent marketing of the patented article or use of the patented process. Even if the innovator had filed a patent application at the time the invention is
placed on sale, a patent application can be filed later, and although subject to a heavy burden of proof, may mature into a patent which could be used to block the first to market a product. Patent prior user rights could protect an inventor, who was unable to timely file a patent application, from liability based on patent applications filed after a product was introduced. This type of protection traces its roots to the English Statute of Monopolies of 1624 which provided protection for inventions "which others at the time of making such Letters Patents and Grants shall not use." The purpose of the English patent law is similar to the protection afforded if a prior user rights bill is passed. The prior user rights bill would provide a shield to protect against patent liability from patents filed or claiming priority after use commenced.

If the House bill must have the appropriate safeguards which make the rights granted personal and protect against asserting rights based on prior use if the prior use arose out of information obtained or derived from the patentee or those in privity with the patentee, or abandoned on or after the filing or priority date of the patent. This properly restricts the prior use right to parties that are entitled to the right. Further, the right of prior use is only available to one who, prior to the asserted patent filing or priority date, commercially used, or made effective and serious preparation to use, the patented invention. "Commercially used" and "effective and serious preparation to use" should utilize the same carefully crafted definitions that the Senate bill contained to prevent parties who have merely conceived of an invention; reduced an invention to practice in a confidential manner; or reduced an invention to practice without: a) commercializing, or b) investing in the invention; from utilizing a prior user right to escape liability from patent infringement.

Further, the prior use right only extends to technology that was used prior to the filing or priority date of the patent and would otherwise infringe claims of the patent. Thus, if the prior user must infringe additional claims of a patent that were not foreseen at the time of the filing or priority date, then no prior use defense is available for these claims. Improvements that infringe on additional claims of the patent, even if the improvements are perfected before the patent issues, must not be shielded from patent infringement by prior user rights. However, if the prior user right is similar to the Senate bill, then it does allow for increases in the volume of commercial activity or reasonable commercialization of an activity that can be proved to have been clearly underway utilizing the effective and serious preparation provision in lieu of actual commercialization. As discussed below, the private nature of the prior user right must be more carefully crafted then it was in the Senate bill.

Benefits Both Large and Small Industries and Harmonizes US Law with Existing International Law

If an inventor cannot determine if a patented technique is infringed because the patented product sold does not reveal the process or apparatus, a patent may have very little commercial value to offset the high cost associated with obtaining a patent. In this case, a basic premise underlying the US Patent system is not fulfilled. The public will obtain the value of disclosure; however, the inventor will not enjoy a period of exclusive use of her patented invention. For this reason, many inventions are maintained as trade secrets within a company. However, trade secret protection can leave a company exposed to an injunction, which could shut down a business venture, based on patent protection obtained after a product is initially introduced into the marketplace. Prior user rights would provide a limited shield against such action that would be available to small and large industrial concerns. For example, many small Silicon Valley software houses produce some of the most innovative software products available in the world today. However, very few of these concerns avail themselves of patent protection because of the cost of obtaining a patent and time constraints. These companies, as was voiced at the recent hearings, run the risk of encountering "submarine patents" which is a term used to refer to a patent that issues many years after a technique has first been commercialized and marketed, unknown to the USPTO due to their limited database of prior art in the software area. Currently, the threat of suit under a submarine patent requires costly litigation or the payment of significant sums to obtain a license to the claimed invention.

Foreign inventors encounter the same problems in their jurisdictions. However, most countries afford inventors the shield of prior user rights. For example, if an American obtained a patent in Germany for a device that existed in Germany before the American's filing date, the American could not successfully assert the patent in Germany. Currently, a German may be able to assert a US patent against a US inventor even if the patented device existed in the US before the file date. This injustice alone warrants the passage of prior user rights legislation in the United States. Prior user rights would provide a defense that strikes a good balance between trade secret law and patent law as will be discussed next.

Good Balance Between Trade Secret Law and Patent Law

A carefully architected prior user rights bill that protects the interests of patent owners and trade secret must strike a good balance between trade secret law and existing patent law. Under current law, prior users of trade secrets and other technology that is not published or otherwise disclosed cannot be assured that another party will not patent the underlying technology and sue them for patent infringement. Prior rights legislation must be carefully crafted as discussed below to avoid unnecessary conflicts with current rights that are exclusively dedicated to patent law. However, where inventions are naturally not disclosed due to their integration into the internals of a product, patents covering these inventions may be extremely difficult to enforce and thus provide very limited protection to the inventor. The Senate bill was carefully structured to provide limited protection for prior use that did not enter into the realm of patent law any more than was necessary to protect prior users and negate the necessity of obtaining patents on each detail of a product before marketing commences. The strong incentive provided to patent important inventions for which licensable protection can be obtained would remain if a prior user right bill were passed. However, inventors may not be forced to file patent applications on small improvements that represent insignificant advances in technology if they can rely on the protective shield of prior user rights.

Requires Clarification For Software Developers

The Senate prior user right bill provides an explicit proviso facilitating sales of ever increasing numbers of products without personal liability for patent infringement attaching. However, the bill explicitly prohibits the holder of the prior user right from licensing or assigning the right except in connection with the assignment or transfer of the entire business or enterprise to which the rights relate. This leaves a licensor of a product from a holder of a prior user right in a precarious position. Is it the intent of Congress to shield the prior user right holder, but not the customers that utilize products distributed by the holder of the prior user right? One could conclude that Congress intends a user to turn to the holder to indemnify the user from a suit alleging patent infringement. However, such Congressional intent is not explicitly provided in the legislation. Many of the Software Industry Coalition members regularly license software. It is imperative that a licensed software product marketed before the filing or priority date of a patent is shielded from infringement of the patent by prior user rights. **Thus, the Software Industry Coalition would strongly urge the addition of the following language to Section 2(E)(1) at the end of the section:** "However, a holder of rights based on prior use shall have the right and power to indemnify any product sold, licensed or otherwise transferred by the holder utilizing the prior use defense."

CONCLUSION

The Software Industry Coalition strongly supports prior user rights legislation similar to the S.2272 bill. Both large and small US industries, particularly the rapidly growing software industry, benefit from this legislation and currently suffer under the burden and uncertainty associated with a first to invent patent system that has no prior user rights. By enacting a prior user right, Congress will be harmonizing US law with existing international law and striking a delicately crafted balance between trade secret law and patent law. However, we feel it is imperative to remove the cloud under which a prior user may distribute a product by amending the language of Section 2(E)(1) to clarify a prior user's right to indemnify a recipient of a product containing material shielded by a prior user right.

APPENDIX 4.—LETTER FROM HAROLD C. WEGNER, PROFESSOR OF LAW AND DIRECTOR OF THE INTELLECTUAL PROPERTY LAW PROGRAM, NATIONAL LAW CENTER, THE GEORGE WASHINGTON UNIVERSITY, TO HON. WILLIAM J. HUGHES, CHAIRMAN, SUBCOMMITTEE ON INTELLECTUAL PROPERTY AND JUDICIAL ADMINISTRATION, SEPTEMBER 13, 1994

The George Washington University
WASHINGTON DC

Harold C. Wegner
Professor of Law and Director of the
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NATIONAL LAW CENTER

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September 13, 1994

The Honorable William J. Hughes
Chairman, Subcommittee on Intellectual
Property and Judicial Administration
Committee on the Judiciary
United States House of Representatives
Washington, D.C. 20515

Re: *Prior User Rights*

Dear Chairman Hughes:

Permit me to congratulate you on holding a public hearing on the issue of prior user rights. Although legislation has not been introduced in this body, I understand that today's considerations are focused upon an excellent bill that has received favorable consideration by your colleagues in the Senate, S. 2272, *Patent Prior User Rights Act of 1994*, that was introduced by Hon. Dennis DeConcini, Chairman of the Subcommittee on Patents, Copyrights and Trademarks of the Senate Judiciary Committee.

This may be my final opportunity to thank you for your leadership in the intellectual property community here on the Hill. Thank you very much for your inspired leadership.

While there is much to benefit American industry from today's legislation, the bill also takes into account the serious safeguards recommended by leaders of our university research community. It is fully in line with the major points raised by the university community in its participation in the Report of the Advisory Commission of the United States Secretary of Commerce (1992).

The legislation creates a "win win" situation for American industry that eliminates the need for defensive process and software filings, and thereby reduces the burden on the patent examination system.

GEORGE WASHINGTON UNIVERSITY NATIONAL LAW CENTER

The proposed legislation is an early harvest benefit of the patent harmonization discussions that have now been going on for a full decade. The rest of the world creates an uneven "road game" for Americans abroad: American patentees gain little from the foreign prior user right laws, having their patents undercut by foreign (domestic) manufacturers. Today's legislation rights the balance, creating a pro-American case to encourage manufacture within our shores, to benefit American industry that creates innovations at an early date, and which gives not one iota of benefit to a foreign manufacturer: Even if he manufacturers before the date of a U.S. patent filing, he gains nothing under today's legislation.

Prior User Rights are Invoked Only in Very Rare Cases

The overall impact of prior user rights on American industry would in any event be extremely small. How often, *today*, is there a case where a prior inventor has invalidated a second inventor's patent solely on the basis of proof of an earlier date of invention — where there was not some other "prior art" basis such as a pre-publication or public use of the invention? The occasions of such prior invention defeating a patent of a second inventor are extremely rare. For a more detailed review of the infrequency of the invocation of the prior user right, see the study conducted by Lisa M. Brownlee, *Trade Secret Use of Patentable Inventions, Prior User Rights and Patent Harmonization*, 72 JOUR. PAT. & TRADEMARK OFF. SOC'Y 523 (1990).

The Limited — But Important — Setting for Prior User Rights

The Brownlee view that prior user rights have only a limited overall impact on the American patent system is undoubtedly correct. However, in some key industries the impact can be a "win win" situation for both American industry and the administration of the patent system.

The "win win" areas are where American industry develops an invention that it wants to maintain in secrecy yet commercialize. This may occur, for example, in secret industrial processes that relate to discrete improvements in chemical or biotechnological processes, or to software technology that the proprietor is loathe to patent.

Why shouldn't innovators in these areas seek patent protection? They receive very little benefit in the sense that it is very difficult to police patent infringement involved with chemical or biotechnological process inventions or with some software inventions. The tax on the system for patenting in these areas is unacceptable vis a vis the burdens on the innovator.

Often, the only reason to patent is *defensive*, i.e., to gain a patent so that a later inventor cannot obtain his or her own patent. The situation is onerous because once an invention has been commercialized by the trade secret owner, soon it is impossible to obtain a patent: One year from the date of first commercialization, the trade secret owner is barred from obtaining a patent. This is not due to the statute, but instead the result of judicial legislation crafted from the pen of the late Learned Hand in *Metallizing Engineering Co. v. Kenyon Bearing & Auto Parts Co.*, 153 F.2d 516 (2d Cir.), *cert. denied*, 328 U.S. 840 (1946). As a result of *Metallizing Engineering*, a late-comer who independently invents the subject of the trade secret may obtain a patent, yet the true first inventor is stymied because he or she is *barred* from obtaining a patent under Judge Hand's precedent (and also would lose a priority contest — a "patent interference" — because of the provision in the law that denies priority under 35 USC § 102(g) to one who has "concealed" his or her invention).

When the United States was a "patent island" — where foreign patents and foreign commercial activity did not have such a direct bearing on our economy — the philosophy of *Metallizing Engineering* was excellent: *Domestic* competition was fostered by this decision, and owners of secret processes were encouraged to use the patent system to divulge their trade secrets.

Metallizing Engineering makes much less sense today in a world where patenting the invention in the United States necessarily results in *publication* in the form of a patent of the "guts" of the previously secret technology: This is a prescription for "me too" copying in the rest of the world where patents either are not obtained or at best only poorly enforceable. The net result of *Metallizing Engineering* puts the inventor of a new process or software in a Catch 22 situation: Patent or you won't have a right to continue to use your invention if a third party independently patents the same subject matter. Yet patent, and you will lose your exclusivity on a global basis, automatically providing an invitation to competitors around the world to copy the technology thanks to the disclosure of the invention in the patent.

The patent system is also a big loser: Why should patent applicants flood the system with *defensive* patents in process or software technology, when the main goal is *defensive*? Is it not better to provide the innovator with a safe harbor defense to patent infringement, permitting no administrative costs to the system of any kind unless and until an infringement threat would be raised by a junior inventor?

It is particularly important that today, when the administration of the patent system is hounded by difficulties in the handling of software patent applications, Congress should act to mitigate the problem by finding non-patent opportunities for today's defensive filers.

The Academic View: A Victory For American Industry

The patent law academics have generally recognized that there is an imbalance, an uneven playing field between native and foreign industries under a prior user right system. Thus, the classic prior user right model that would apply also in the United States restricts the prior user right to *American* prior user right. Jobs *in America* are protected. Thus, with nearly half of all patents owned by foreign concerns and with most having manufacturing first in their "home countries", it is clear that such foreign patentees would not gain anything by the prior user right law. To the contrary, American industries that manufacture with slow filing or no filing of patents would be safeguarded by a prior user right system that *discriminates on* the *basis of domestic manufacture*. Thus, American industry, only, would benefit from the prior user right provision. (Foreign concerns would be able to benefit only by shifting their manufacturing basis to within our shores, but certainly this, too, is a positive — more manufacturing jobs for Americans.)

Professor Donald S. Chisum, *The Harmonization of International Patent Law*, 26 J. MARSHALL L.REV. 437 (1993), citing R. Carl Moy, *The History of the Patent Harmonization Treaty: Economic Self-Interest as an Influence*, 26 J. MARSHALL L.REV. 457 (1993), notes that several commentators including "Moy agree that it would be in the national competitive interest of the United States to recognize a prior user right because the right can be based only on pre-filing activity in the United States and, consequently, only favors United States industry and workers in relation to United States patents, a significant percentage of which are held by foreign companies." Moy specifically urges that "[prior user] rights would * * * remove wealth from patent owners, a class of persons in which foreign nationals can be numerically commonplace, and transfer it to domestic industry and consumers. Prior-user rights therefore protect domestic wealth from the incursions of foreign patentees." *Id.*

Exhaustion of the Patent Right and the Rights of Consumers

At first blush, one may wonder: Even if I am exempt from patent liability because I am the prior user, what about my customers who purchase my patent-exempt goods from me? Are they *also* exempt? Obviously, they must be, or the prior user right system would be entirely meaningless. For example, consider the following situation:

Acme Widget Company produces Acme-brand widgets for several years in its Flagstaff, Arizona, manufacturing facility, and sells these widgets to its customers for the purpose of incorporating them in Widget-coated convertible tops. Years after this commercial activity has commenced, a patent application is filed by Zenon Widgetry with a claim eventually granted in a patent to Zenon Widgetry that dominates the use of the Acme Widget Company's Acme-brand Widgets.

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Manifestly, Acme Widget Company has a prior user right under the proposed legislation — so, too, must its customers who buy Acme-brand Widgets. Otherwise, Acme Widget Company would have no power to continue to sell its Acme-brand Widgets because they would be infringing uses of the Zenon Widgetry Patent.

The problem, here, is not new. More than a century ago the Supreme Court addressed the problem of a patentee seeking to control a customer's use of a patented invention after the first sale of embodiments under the patent. In *Adams v. Burke*, 84 U.S. (17 Wall.) 453 (1873), the patentee licensed the sale of coffins for resale outside the greater Boston area. When customers of the licensee resold the coffins in Boston, the patentee sued. This interference in commerce where the patentee had once sold his goods was found to be an improper interference with commerce. The Court said that "when the patentee, or the person having his rights, sells a machine * * * whose sole value is in its use, he receives the consideration for its use and he parts with the right to restrict that use." Unlike the situation in *Adams*, here the rights of the seller are through the prior user right. The same reasoning should apply.

The problem is totally hypothetical and not at all real. Only if one has the "exhaustion" theory is it possible to have a real prior user right. In the century or so of prior user right laws around the world this has been the practice: Without such an interpretation, a patentee who has a prior user right would never be able to use that prior user right because his customers would become patent infringers.

University Inventions and University Rights

The university community is the source of a major share of patent rights of great value to our domestic economy, both for the self-evident financial rewards and the jobs that are created, but also for the benefits to mankind that occur in the health care field as well as providing a more comfortable living for consumers everywhere.

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With the particular help of Howard Bremer, the renowned former head of the Wisconsin Alumni Research Foundation and a key leader and former President of the Association of University Technology Managers, the Report of the Advisory Commission both recognized the importance of the contributions of the academic community to research and the need to carefully limit the scope of prior user rights. Undoubtedly due to the presence of Mr. Bremer on the Advisory Commission, that body supported a prior user right bill *only* with critical limitations in the scope of the prior user right.

In my 1993 book, PATENT HARMONIZATION, I devote an entire chapter to this important subject, § 1100, pp. 119-138. I share the concerns of the university research community that a prior user right bill should be quite limited in scope. Indeed, the legislation proposed by Senator DeConcini fully meets each and every objective for a limited prior user right, a "delicately balanced compromise" that both addresses the interests of domestic industry while honoring the rights of the university research community.

* * *

The remarks presented to you today are on my own behalf and do not necessarily reflect the views of any institution with which I am affiliated.

Mr. Chairman, let me again congratulate you on including hearings before your subcommittee at this late date in the session.

Respectfully submitted,

Harold C. Wegner

APPENDIX 5.—LETTER FROM THOMAS E. SMITH, SECTION CHAIR, SECTION OF INTELLECTUAL PROPERTY LAW, AMERICAN BAR ASSOCIATION, TO HON. WILLIAM J. HUGHES, CHAIRMAN, SEPTEMBER 21, 1994

AMERICAN BAR ASSOCIATION SECTION OF INTELLECTUAL PROPERTY LAW
750 N. Lake Shore Drive
Chicago, Illinois 60611
312/988-5598
FAX: 312/988-5500

SEP 2 . 1994
SUCC. ON . .

September 21, 1994

Representative Hughes
Chairman
Subcommittee on Intellectual Property
and Judicial Administration
UNITED STATES HOUSE OF REPRESENTATIVES
207 Cannon House Office Building
Washington, D.C. 20515

Re: Oversight Hearings on Patent Prior User Rights

Dear Congressman Hughes:

It is our understanding that an oversight hearing was recently held by your committee on the issue of whether or not there should be prior user rights in our present first-to-file patent system. We wish to place on record the opposition of the American Bar Association ("ABA") to legislation aimed at providing, in our first-to-invent patent system, broad, unrestricted prior user rights to persons who are not prior inventors. We specifically oppose legislation, such as the type recently introduced in the Senate (S-2272) which in a first-to-invent patent system would give exclusive patent rights only to one who is first-to-file, absolve infringers who commercialize prior to filing, and totally ignores the first inventor's rights.

The ABA is a voluntary, national membership organization of the legal profession. The more than 360,000 members of the ABA come from every state and territory and the District of Columbia. The Section of Intellectual Property Law ("Section") of the ABA includes over 13,000 ABA members interested and having expertise in Intellectual Property Law. Over a period of many years, the ABA and the Section have contributed to the development of a system for protection of intellectual property and thereby advance the technological development of our nation. Many members of the Section practice in the field of patent law, representing patent owners and other persons in businesses affected by patents.

The ABA believes that the prior user rights issue is of significant importance to the patent system and to the technological development of our nation. The following resolution sets forth the existing policy of the ABA:

> RESOLVED that the American Bar Association disapproves in principle changing the present law to give a party the right to continue the practice of an invention in the United States if he had begun commercial manufacture, or sale in the United States, or had made substantial preparation for the practice of the invention in the United States prior to the earlier of the patentee's effective filing date or first public disclosure ...

That policy has been in existence since 1968, and on August 5, 1994, the Section reaffirmed its support for the ABA policy by adopting a resolution which "opposes in principle granting prior user rights to a person who has used the invention as a trade secret in a way so as to have suppressed or concealed the invention under § 102(g), Title 35 USC, and specifically opposes S-2272... in its current form or equivalent legislation."

The United States patent system is a first-to-invent system and broad unrestricted prior user rights, such as would be provided under Senate bill S-2272 for example, are totally inconsistent with that type of a system. While prior user rights are widely recognized throughout the world, they are only recognized in conjunction with first-to-file patent systems. In a first-to-file system, the only "critical date" is the filing date. In this country, under a first-to-invent system, the "critical date" is the <u>invention date</u>, a date not mentioned or recognized in S-2272. That type of legislation does not protect prior inventors! Such legislation recognizes only two events, (1) the effective filing date, and (2) commercial use or preparation. The legislation in essence endorses and rewards only first filers, or first commercial users. In the United States, most inventions are made by independent inventors and employees of small companies. When an invention is made by an independent inventor or an employee of a small or medium size company, before spending money to file a patent application, most want to find out (1) whether the invention will work, (2) whether the invention can be improved upon, and (3) whether the invention is of commercial value. Until these matters can be determined, the company's exclusive rights are protected by our first-to-invent patent system. Legislation of the type proposed in S-2272 would take those rights away, at least to the extent that another company comes in and proceeds to commercialize, or make plans to commercialize the invention. Indeed, under the provisions of S-2272, the first inventor could have invented and even commercially used his invention but would not be able to prevent the infringement by another company who, without derivation, began commercialization after the first inventor's invention date, and perhaps after commercialization by the first inventor, but before the first inventor files his patent application. That type of legislation in effect tells inventors that they had better be on a first-to-file system, even though the United States patent system is a first-to-invent system. That type of prior user right which fails to recognize a first inventor's rights is incompatible with and even antagonistic to our present first-to-file system.

Large companies with substantial patent portfolios in first-to-file foreign countries already consider themselves to be operating under a first-to-file system, and a first-to-file system clearly favors big companies with deep pockets who can more quickly determine the value of an invention or who can most afford to file on speculation. Small companies can't do that, and independent inventors have to find prospective users before they can afford to file on their inventions. Any legislation which favors only those who file first or commercialize first, in effect favors large companies and gives those companies even greater advantage over their smaller competitors. It is, thus, understandable that large companies support broad, unrestricted prior user rights legislation and even support a first-to-file system, regardless of whether it comes with any concessions from foreign countries. If the United States is ultimately to adopt a first-to-file system, it should be with substantial concessions from foreign countries, and if we, in effect, place the United States on a first-to-file system by imposing broad, unrestricted prior user rights upon our present first-to-invent system, we are giving away the biggest and best bargaining chip the United States has.

In 1982 the Intellectual Property Law Section (then the Patent, Trademark and Copyright Law Section) adopted a resolution which favored, in principle, legislation providing an *in personam* right, or right of prior public user, to the first inventor who elects to keep his invention a trade secret, and further providing that the patent on the same invention, which was independently discovered by a subsequent inventor, shall not be held invalid based upon the trade secret public use of the first inventor. In reviewing the record of the Section debates which resulted in the adoption of that resolution it becomes apparent that the membership of the Section was not made aware of the prior resolution of the ABA. Moreover, that 1982 resolution was directed to legislation which provided an *in personam* right to the first inventor who commercialized, not just a right to anyone who came along to commercialize the invention, as legislation such as S-2272 would do. In other words, the 1982 resolution of the Section recognized and expanded the first inventor's rights; it did not give rights to first filers or first commercializers. That 1982 resolution of the Section recognized only the prior inventor who is a prior public user and thus was completely consistent with our first-to-invent patent system. Under no circumstances could that resolution be considered an endorsement of broad prior rights legislation under which first inventor's rights are ignored and only the effective filing date of the patentee and the date of commercial use of the infringer are important. The 1968 resolution of the ABA specifically opposes broad and unrestricted prior rights legislation which only recognizes either the effective filing date of the patentee or the commercial use or preparation by the infringer.

Broad and unrestricted prior user rights legislation would make patent litigation more expensive by opening up a whole new defense to patent infringement, and it would make patent filing more expensive by placing a premium on including in the application additional claims of varying scope to limit the right of the prior user to make later non-infringing improvements and variations.

Such legislation would, in effect, turn our present first-to-invent system on its ear. It is totally inconsistent with a first-to-invent system. The ABA policy adopted in 1968, and reiterated by the Section in 1994, clearly opposes this type of legislation, which would do significant damage to the U.S. patent system.

Sincerely,

Thomas E. Smith
Section Chair

TES:kk

pc: Officers
Mrs. Michele A. Bridges

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APPENDIX 6.—LETTER FROM ROGER S. SMITH, PRESIDENT, INTELLECTUAL PROPERTY OWNERS, TO HON. WILLIAM J. HUGHES, CHAIRMAN, SEPTEMBER 23, 1994

IPO INTELLECTUAL PROPERTY OWNERS

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September 23, 1994

The Honorable William J. Hughes
Chairman
House Judiciary Subcommittee on
Intellectual Property and Judicial Administration
207 Cannon House Office Building
Washington, DC 20515

Dear Mr. Chairman:

I request that this letter, written on behalf of Intellectual Property Owners (IPO), be made a part of the record of the hearing on prior user rights that was held by your Subcommittee on September 13, 1994.

IPO is a non-profit association that represents companies and individuals who own patents, trademarks, copyrights, and trade secrets. IPO members are responsible for a substantial portion of the private research and development performed in the United States. During 1993 IPO members were granted about 12,000 United States patents, 23 percent of all U.S. patents granted to U.S. nationals.

IPO endorses the concept of prior user rights for manufacturers who commercially use a patented invention, or make serious and effective preparation to use it, before an application for a patent is filed. IPO strongly supports enactment of the bill that is pending in the Senate, S.2272, the "Patent Prior User Rights Act of 1994".

<u>Prior User Rights in General</u>

We believe the Patent Prior User Rights Act of 1994 is important legislation that will materially improve the functioning of United States patent and trade secret laws. The bill strikes a balance between the rights of patent owners and the rights of prior users of patented inventions, who include trade secret owners. By clarifying the rights of prior users in the United States, the bill if enacted will provide greatly needed certainty about rights in technology and reduce the expense of protecting intellectual property.

In essence, S.2272 provides that a U.S. manufacturer will not be liable for infringement of a patent owned by another party if the manufacturer commercially uses the patented invention, or makes effective and serious preparation to use it, before the other party files for a patent. It is not clear that existing law is different from this, but neither is it clear under existing law that a prior user whose use does not create a public disclosure can continue that use in the face of a later filed patent.

Clarification of the point has been needed for years, but we know of no case that deals squarely with it. Globalization of the economy and the high cost of patent litigation have added urgency to the need for clarification. The statutory right inS.2272 to continue to use technology in the face of later-filed patent applications is the best solution.

Protecting Trade Secret Owners

S.2272 is a carefully crafted bill that protects the interests of patent owners and trade secret owners. Under current law, prior users of trade secrets and other technology that, by its nature, is practiced away from the public's view cannot be confident that another party will not patent the technology and sue them for patent infringement. Sometimes people have a knee jerk response that protecting prior users of trade secrets will exalt secrecy over the public disclosure of inventions that is encouraged by the patent system, and that the bargain theory of the patent right will be frustrated.

We believe secret use of technology cannot be dismissed as necessarily less beneficial to society than publicly disclosed use. Many important technological achievements -- notably processes -- can only be effectively exploited through secret use. Processes are naturally practiced away from the public's view in most cases. Patents covering them consequently are very difficult to enforce, so process patents often do not provide meaningful protection.

The Supreme Court of the United States in its landmark 1974 opinion in Kewanee Oil Co. articulated how patent law and trade secret law both encourage innovation. Patent law, the court explained, promotes innovation by offering a right to exclude competitors for a limited period of time and inducing public disclosure of patented inventions. The court recognized, however, that trade secret protection for inventions that could have been patented does not conflict with the patent policy of public disclosure of technology. The court said:

> Trade secret law and patent law have co-existed in this country for over 100 years. Each has its particular role to play, and the operation of one does not take away from the need of the other...

A U.S. manufacturer should not be expected to disclose its proprietary processes to the world, including foreign competitors, through the vehicle of hard-to-enforce patents in order to assure the continued right to use them in this country.

In addition to processes, there is a need to protect other innovations in which significant investments are made during the period that they are under development and before public use assures their protection against subsequent inventors. S.2272 accomplishes this in a fair way by protecting effective and serious preparation for use. This obviates the need for a manufacturer to incur the expense of patenting every minor improvement or publishing a disclosure of every minor improvement in order to defeat the right of others to obtain a patent.

If S.2272 is enacted, the incentive to patent substantial, protectible inventions will be unchanged. Inventors may not feel compelled to file as many patent applications on minor inventions, such as improvements made during routine product development, as they would if a prior user right were not assured. On the other hand, the incentive to obtain patent protection where it can be effectively exploited by the rights to exclude or to reap royalties will continue to far outweigh the incentive to maintain secrecy. Trade secret protection does not prevent other parties from independently creating an invention and using it in the United States. A prior user right in the United States does not insulate a manufacturer from exclusion from all foreign markets by foreign patents filed later by other parties.

Prior User Rights Abroad

Prior user rights provisions are common in foreign patent systems. A study of 46 countries by the World Intellectual Property Organization in Geneva in 1988 reveals that the vast majority have a right in their patent laws to use a patented invention based on possession, use, or preparation for use before the filing date or priority date. In certain countries -- for example, Belgium and France -- prior user rights are too broad because a prior user right is recognized for a party who merely possesses knowledge of the invention earlier than the patent filing date. Such overbroad prior user rights need to be reined in through international negotiations because they diminish the value of exclusive patent rights.

Most of our major trading partners, however, have prior user rights similar to those proposed in S.2272, and those systems work well. Litigation involving enforcement of prior user rights is rare in other countries, and such litigation will not become significant in the United States. S.2272, consistent with the approach used in other countries, limits the rights to those parties who have commercially used or made effective and serious preparation for commercial use in this country. Foreign countries base their prior user rights on the earlier of the domestic patent application filing date or Paris Convention priority date, as does S.2272. Other countries do not give patent owners compensation for use of patents by prior users, who in many cases are the first inventor and advance the public interest by manufacturing. S.2272 is correct in adopting that policy too.

Provisions in S.2272

The definitions and the qualifications on prior user rights proposed in S.2272 are satisfactory.

For example, the term "commercially used" is defined to include the use of processes, equipment, tooling, and intermediate materials in the design, testing, or production of commercial products. The definition makes clear that commercial use includes use that is maintained as a trade secret. "Effective and serious preparation" has to involve reduction to practice of the invention plus serious plans for, and a significant investment in, commercial use.

Preparations for commercial use that are substantial and material should give rise to prior user rights, provided they represent activity toward actual commercialization as opposed to mere plans or preliminary efforts toward subsequent activity. We endorse the following factors recommended by the 1992 Advisory Commission on Patent Law Reform, among others, for determining whether effective and serious preparation for use exists:

1. The costs incurred by the prior user by the time of filing of the patent, as well as the relation of those costs to the total cost for commercialization of the subject matter of the prior user rights;

2. The amount of time required for the prior user to complete the preparation for commercial use after the filing date, and the proportion of that time in relation to the total time necessary to fully prepare for the prior use;

3. The complexity of preparation for practicing the claimed prior use; and

4. The diligence of the prior user in preparations for the prior use.

The bill provides that subsequent variations and improvements on an invention which had been used prior to the patent owner's effective filing date do not infringe the patent only if they do not cause infringement of additional claims of the patent. The right created by prior use or preparation should be limited to continuation of the kind of activity which gives rise to the right. In the case of processes, this should limit the right to a continuation of use of an identified process, but should not limit the products produced or affected by the process.

The prior user should be able to expand the prior use to meet market demands, rather than being restricted to the pre-filing volume of use. Prior users should not be restricted to a particular geographical area within the borders of the United States, as entities commonly conduct development and commercialization activities in different sites throughout the United States.

The bill lists several desirable qualifications on rights based on prior use:

(1) prior user rights are personal and cannot be transferred except in connection with transfer of the entire business or enterprise which the rights relate;

(2) prior user rights are not available if the prior use was based on information derived from the patent owner or parties in privy with the patent owner, or the prior user's activity was abandoned;

(3) prior user rights do not cover all claimed subject matter of the patent, but only that subject matter that was commercially used or for which there was serious and effective preparation in the United States before the filing date.

These limitations are needed to prevent abuses of the prior user right that would improperly diminish the value of the patent against which the right might be asserted.

We understand the prior user rights of S.2272 to be legal rather than equitable rights. A legal prior user right is important in the interest of clarifying the metes and bounds of the right. Under S.2272 a court would not have the authority to assess reasonable royalties in favor of the patent owner for use by the prior user, nor to expand or contract the prior user right in the interest of equity. The prior user right would be an absolute defense to infringement once the elements of the right were proven by a sufficient showing of prior use. Rigidly enforced qualifications for establishing the prior user right, including the requirements of independent innovation and actual reduction to practice, will ensure that the right will be invoked infrequently, and if invoked, sustained only where truly merited.

If the court were given authority to assign royalties for prior use and to expand or diminish the prior user right, it would complicate the right and create uncertainty that could lead to unnecessary litigation. If faced with the possibility of paying royalties in the domestic market, manufacturers might build plants overseas where prior users do not face the threat of being forced to pay compensation to patent owners.

Conclusion

S.2272 will benefit large and small U.S. manufacturing concerns. Today businesses large and small are finding that the cost is prohibitive to protect all inventions, including minor improvements, with worldwide patents. Particularly in the case of process inventions, for which trade secret protection is a practical and often the best alternative, an assured prior user right will improve the climate for innovation by enabling the first domestic commercial user to protect its investment in research, development, and commercialization at a lower cost.

Non-manufacturing patent owners have expressed fears in the past that prior user rights might undercut the licensing value of patents, but we do not believe there is reason for concern, particularly if the rights are limited as provided in S.2272. Experience abroad suggests that prior user conflicts rarely occur, so most patent owners will not encounter them. That does not mean that prior user rights are unimportant to manufacturers. It is the possibility -- not the frequency -- of a complete prohibition of continued use, that pushes U.S. manufacturers toward unnecessary patenting or disadvantageous publishing of manufacturing technology.

The business community cannot afford to wait for clarification of the rights of prior trade secret users through case-by-case judicial interpretation of the existing patent code, an uncertain prospect. The competitive pressures on U.S. businesses are such that Congress should enact S.2272 separately from the other patent system reforms now on the drawing board.

S.2272 balances patent rights and prior user rights in a way that will strengthen the technological competitiveness of U.S. industry. The bill should be enacted into law this year.

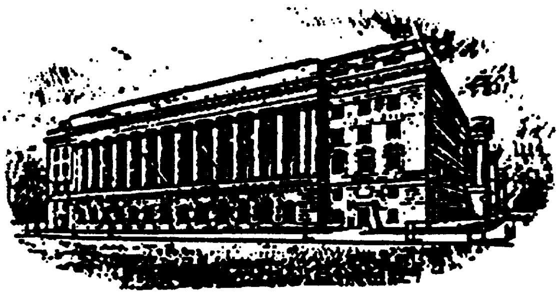
Sincerely,

Roger S. Smith
President

cc: Members of the Subcommittee

APPENDIX 7.—THE ADVISORY COMMISSION ON PATENT LAW REFORM, AN EXCERPT FROM A REPORT TO THE SECRETARY OF COMMERCE, AUGUST 1992

THE ADVISORY COMMISSION ON PATENT LAW REFORM



A REPORT TO THE SECRETARY OF COMMERCE

AUGUST 1992

(c) Prior User Rights

The issue of prior user rights presented difficult questions that the Commission had to address pursuant to its deliberations on the first-to-file issue. Under the appropriate circumstances, a prior user right will enable an earlier user of a patented invention to raise a defense to a claim of patent infringement. To establish the prior user right, the prior user must show that they independently developed the invention and began use or substantial preparation for use of that invention prior to the filing by the patent owner. If the extent of pre-filing activity was sufficient, the prior user will be permitted to continue such use despite the presence of the patent, subject to specific limitations on the extent of that use.

Prior user rights provisions are common in many first-to-file patent systems.[18] Such rights commonly provide a limited defense against an infringement claim where the prior user defendant can establish commercial use, or substantial preparation toward such use, of the patented invention in that country prior to the effective filing date of the patent.[19] Prior user rights are also authorized in Article 20 of the Basic Proposal of the WIPO Patent Harmonization Treaty draft.[20]

Prior user rights, as such, do not exist in U.S. law. The fundamental concept, however, is partially filled by 35 U.S.C. § 102(g), which provides that an applicant will be entitled to a patent in the United States unless "before the applicant's invention thereof the invention was made in this country by another who had not abandoned, suppressed, or concealed it."[21] In operation, this enables a prior inventor who has not abandoned, suppressed or concealed the invention to invalidate the later filed patent of another, thereby escaping liability for infringement. In a first-to-file system, section 102(g) would be inapplicable, as priority in rights to a patent would be keyed upon filing of the patent application, rather than priority in inventorship. However, prior user rights, as contemplated by the Commission and as in place in foreign systems, differ in several respects from operation of 35 U.S.C. § 102(g). One significant difference is that the prior user right, as it exists in foreign systems, is a personal defense and does not have a patent defeating effect, as is the case under existing U.S. law.

Prior user rights are intended to provide a degree of balance in a first-to-file system by providing some protection to an earlier independent inventor.[22] The basic difficulty in providing a prior user right is crafting the right so that it does not undercut the value of the exclusive rights obtained through patent grant, or the desirable goal of early disclosure of inventions stimulated by a first-to-file system.

Advocates and opponents of prior user rights have identified several reasons to either include or preclude such rights in a U.S. first-to-file based patent system. The Advisory Commission has considered the merits of these arguments at length. While not unanimous in all respects, the consensus of the members of the Advisory Commission is to support the establishment of a limited prior user right as part of a U.S. first-to-file patent system. It is important, however, to recognize the reasons that were offered in support of, or against, prior user rights as these reasons are grounded upon specific concerns of the different sectors of the U.S. patent user community that would be affected by the implementation of such a system in the United States.

Advocates of prior user rights advance several arguments in support of a U.S. prior user right. They point out that prior user rights are designed to benefit those who have independently developed, in the country having the right, an invention in good faith before the effective filing date of a patent application on that invention. Hence, they note, almost every industrialized country protects its national industry by including a prior user right in its patent system. Without a prior user right in the United States, foreign U.S. patent holders could "close down" U.S. prior users, while U.S. owners of foreign patents would remain unable to exercise those patents against prior users abroad. Supporters also argue that without prior user rights, inventors may be encouraged to flood the USPTO with patent applications on numerous minor improvements during product development[23], and that prior user rights cases are extremely rare in countries having the right.[24]

Many proponents of prior user rights also believe there is a need to protect secret uses from the risk of later independent invention and patenting by others. They argue that trade secret use of an innovation is sometimes the best, or only, way to realize the benefit of the investment that gave rise to it. In such cases, it is argued, trade secret protection must be given weight in order to protect U.S. investment. Absent any protection for the secret user, valuable technology may be lost because of the need to disclose it to insure its continued availability for use.[25] Supporters of prior user rights, based on activity that was intentionally protected as a trade secret, argue that inventors can secretly commercialize only a limited set of inventions, mainly certain process or apparatus inventions that are not disclosed by their products. They also maintain that the incentive to obtain patent protection on truly important technology, outweighs the incentive to maintain secrecy, because relying on a prior user right, for example, would not give an inventor any protection abroad.

Those who oppose the right point out the inconsistency of the prior user right, at least insofar as it protects secret use, with the disclosure inducement theory that underlies our patent system. They argue that protection of secret prior use against a granted patent exalts secrecy over public disclosure. Some opponents of prior user rights believe it is not fair to reward an inventor who does not pursue patent protection, particularly those inventors who intentionally conceal an invention in commercial use. Others argue that prior user rights could increase the need for record-keeping, the potential for litigation, and other burdens that characterize current interference practice. Opponents of prior user rights are also concerned that the prior user rights threaten the exclusivity of a patent right and jeopardizes exclusive licensing and sale opportunities, particularly if more than one prior user exists.

The arguments on both sides of the issue are valid and received serious and careful consideration. A prior user right too easily achieved and too broad in scope might do grave damage to the United States patent system and severely impact the incentive to invest in research and development. On the other hand, elimination of the right altogether may make a first-to-file system in this country too harsh, and seriously injure U.S. manufacturing activity.

The Commission believes that providing a limited prior user right to protect the legitimate interests of industry in the United States can be achieved without unduly detracting from the exclusivity and marketability of the patent grant.

The prior user right should exist as a personal defense to an infringement claim, and should be based upon the following elements:

(i) Time and Place

The right should be based only upon activity in the United States prior to the earliest filing date to which the relevant claim or claims of the patent is or are entitled, including a foreign priority date under 35 U.S.C. § 119.

(ii) Independent Creation

The activity must have been done in good faith and without derivation from the patentee, and it must have been based upon the independent development of the person claiming prior use, or of persons who had an obligation at the time of such development to assign or license patent rights to or otherwise share such rights with such person.

The key to this concept of independent creation is that the prior user should not be able to take advantage of the patentee's pre-filing disclosures to create the right which will subsequently be used to avoid liability under the later-issued patent.

(iii) Extent of Prior Activity

The prior user right must be based upon either actual use in commerce of the patented invention, or upon substantial material preparations for such commercial use. In each case it is essential that the subject matter of the patent be the subject matter of the pre-filing use by the prior user. Preparations for commercial use that are substantial and material should give rise to the right, provided they represent activity toward actual commercialization as opposed to mere plans or preliminary efforts toward subsequent activity.

At a minimum, the prior user must have completed an actual reduction to practice of the invention for which the right is claimed, prior to the patentee's earliest filing date, to claim the prior user right defense.

The following factors, among others, should be employed to determine whether substantial preparation for use has been proven by a potential prior user:

(a) the costs incurred by the prior user as of the filing date of the patent, as well as the proportion of those costs to the total costs for commercialization of the subject matter of the prior user right;

(b) the amount of time required for the prior user to complete the preparation for commercial use after the filing date, and the proportion of that time in relation to the total time necessary to fully prepare for the prior use;

(c) the complexity of preparation for practicing the claimed prior use; and

(d) the diligence of the prior user in preparations for the prior use.

The burden of establishing the requisite degree of sufficient prior use by documentary and other objective evidence should be on the party asserting the right.

(iv) Scope of the Right

The right created by prior use or preparation should be limited to continuation of the particular activity which gives rise to the right. In the case of processes, this would limit the use to a continuation of use of an identified process but would not limit the products produced or affected by the process. In the case of products, the right would extend to future editions of the product only if they are not materially different from the version of the product which gave rise to the right. For example, improvements to the prior use should be permitted to the extent they do not fall within the scope of other claims in the patent.

The prior user should be able to reasonably expand the prior use to meet reasonable market demands within the United States, rather than being restricted to only the pre-filing volume of use. In addition, the prior user should not be restricted geographically within the borders of the United States, as entities commonly conduct development and commercialization activities at different sites throughout the United States. The prior user right will not authorize use outside the United States.

(v) Personal Nature of the Right

Prior user rights should be personal in nature, and should not be transferable, except with that part of the business which exploits the right. This is essential to preserve the personal nature of the prior user right, and to prevent the personal right from being extended to resemble a compulsory license-like authority to avoid liability for patent infringement that can be transferred or licensed to others.

(vi) Legal or Equitable Nature of the Right

Prior user rights should be an equitable defense to a charge of patent infringement, and at a minimum should permit continuation of use on the scale of the commercial use undertaken, or for which sufficient preparations were made, before the patentee's earliest filing date. Where the totality of circumstances make it appropriate, a court should have the authority to assess appropriate and reasonable royalties in favor of the patentee, or to expand the right to assure that justice is done.

(vii) Other Elements Not Recommended for Inclusion in the Prior User Right

The Commission, pursuant to its deliberations on the definition of the prior user right, contemplated several other options offered for inclusion in the prior user right proposal. These options would address real concerns expressed during the deliberative process of the Commission. However, the consensus opinion of the Commission is that it would not be appropriate to include these options in the prior user right proposal. For completeness of the record, these options are presented below.

(a) Special Treatment of Non-Manufacturing Entities

One proposal would provide special treatment for non-manufacturing entities in relation to the exercise of prior user rights.

First, it was proposed that non-manufacturing entities be excluded from application of prior user rights, so that the prior user right defense would not be available against a patent held by such an entity. This, in essence, would differentiate operation of the prior user right based upon the identity of the patent holder. The proposal was intended to address concerns expressed by the university community, in particular, that prior user rights would be of little value to universities and small entities because these groups do not commercialize their inventions. Indeed, because such entities rely on licensing of patent rights to realize the value of the patent grant, such rights could disproportionately diminish the value of patent rights for non-manufacturing entities.

An alternative to this proposal would create an administrative process to be implemented through the USPTO that would determine the validity of prior use claims and then use appropriate means to establish fair compensation to the patentee for loss of economic value of the patent. In this alternative, prior users would be required to "register" their claims of prior use with the administrative body and pay a fee for administrative costs; otherwise, they would forfeit the right to raise the prior use defense in subsequent litigation involving the patent.

The Commission ultimately rejected these proposals after thorough consideration. The proposed exclusion of non-manufacturing entities was viewed as overbroad in its scope and seen as possibly chilling industry/university collaboration. Even though prior user rights could not be transferred once created, Government agencies and universities could exercise prior user rights based upon developmental activities that were undertaken by others through contract. As to the proposed administrative process, the Commission viewed this as impractical and unfairly favorable to patent owners. For example, under the system, competitors would be required to alert patent owners of potential infringements and to thereby subject themselves to patent infringement suits. This would require a voluntary admission of liability for infringement, and if no prior user right is established, the entity would be unfairly prejudiced in a subsequent judicial proceeding. Finally, as USPTO determinations are subject to judicial review, this proposal would not remove the prior user rights defense issue from litigation.

(b) Bar Availability of the Prior user Right Based Upon Intentionally Concealed Prior Use

Another proposal offered was to preclude availability of the prior user right when the prior user intentionally concealed the prior use. The rationale for this proposal was that it would be unfair to reward an inventor who intentionally opts for secrecy rather than seeking protection through the patent system. Concerns were expressed that the prior user right would inappropriately elevate secret use to the stature of protected disclosed use as is the case with patent rights, and as such, a restriction such as this would be necessary to make prior user rights more compatible with the disclosure-inducement theory of the patent system.

As proposed, this limitation would not exclude secret preparations absent intent to conceal the invention in commercial use, since most such preparations would be unannounced or private by virtue of their character (e.g., behind the factory gates). However, where an earlier inventor intentionally conceals, or intends to conceal, the invention in commercial use, prior user rights would not be available under their proposal.

Of course, the prior activity on which prior user rights would be based would by definition be secret activity because prior public disclosure by the prior user, whether through publication or public use, would have a patent-defeating prior art effect on a subsequently filed patent application. This is because any earlier public disclosure of an invention *by someone other than the inventor* would bar the patent grant to the later patent applicant. The grace period, personal to the applicant, would not enable the patent applicant to escape the patent defeating effect of prior art or public disclosure of another.

A majority of the Commission rejected this limitation, maintaining that such a limitation could create, in effect, a "compulsory patenting" system, forcing the disclosure of trade secrets. Trade secrets are often the only practical form of protection for certain inventions.[26] For example, it is often impractical to file for patents to minor process improvements, and difficult to enforce such patents abroad. Furthermore, in substance, the distinction between intentionally concealed secret use versus unannounced secret use is nonexistent. In both cases, the effect is that the information is not generally known to the public, cannot be used by others, and will not serve to preclude the grant of patent rights by another. Also, no other country having prior user rights imposes such a limitation. Finally, this limitation would require proving intent with regard to development activities. This will not only prove to be difficult, but will impose significant burdens through additional litigation costs and delays.[27]

(c) Legal Rather than Equitable Prior User Right

A third proposal was to craft the prior user right as a legal defense, rather than as an equitable defense. Doing so would make the prior user right an absolute defense to infringement, once the elements of the right were proven by a sufficient showing of the prior user. As a legal defense, the court would retain limited discretion to set the conditions of exercising the right.

Some of the reasons offered in support of a legal prior user right focus on the desirability of simplifying the process of defining the prior user right. For example, giving the court the authority to assign royalties may create unpredictability and unnecessarily complicate the prior user right. In addition, rigidly enforced prerequisites to establishing the prior user right, including the requirements of independent innovation and actual reduction to practice, will ensure that the right is rarely invoked, and if invoked, sustained only where truly merited.

Other reasons cited were the potential for creation of anomalous situations between U.S. and foreign markets. For example, facing the possibility of paying royalties only in the domestic market, domestic manufacturers may build plants overseas where valid prior users do not face the threat of being forced to pay compensation to patentees who file for and obtain their rights after the manufacturer has begun substantial use of the innovation. Also, no compensation is currently available abroad for U.S. owners of foreign patents by foreign prior users. In the U.S., however, prior users could be forced to pay compensation to owners of U.S. patents, yet nearly 50% of such owners are foreign.

The majority of the Commission, however, believes that the prior user right should be equitable in nature, giving the courts power to assess royalties as well as to expand the prior user right, to ensure that justice is done. The majority of members believes that, as with intervening rights in reissue situations, courts should have broad equitable powers with respect to prior user rights, to make decisions that are situation specific, balancing the right of the patent holder with fairness to the prior user.

(viii) Dissent Position

One Commission member has voiced a strong dissension on Recommendation I-A (iii). He believes that the recommendation would undermine the value of patent rights to the non-manufacturing sector, exalts secrecy over public disclosure, increases the economic burden of enforcing one's patent rights, and reduces the incentive for licensing and investment.

3. Considerations in Formulating the Proposed Package

(a) World Practice

The current first-to-invent system may actually be harming the competitiveness of U.S. interests by not sufficiently encouraging U.S. inventors to file promptly. Except for the United States, Jordan and the Philippines, all other countries having patent systems use the first-to-file rule in awarding priority between competing patent applications. Even when an inventor who did not file first is able to prevail in an interference contest and obtain U.S. patent rights, that inventor will most likely lose such patent rights worldwide to those filing first, either here or abroad.

For many users of the U.S. patent system, filing practices would be unchanged by adoption of a first-to-file procedure. U.S. inventors with global commercial interests must behave now as though the U.S. system was first-to-file to preserve their rights abroad. Parties who do not adopt this approach commonly forfeit their rights abroad through pre-filing disclosures. Furthermore, foreign entities, which account for slightly less than half of all U.S. patents, are, in fact, already in a first-to-file mode due to practices in their home countries.

It is also useful to consider that Canada successfully replaced its first-to-invent system with a first-to-file system in legislation that took effect in 1989, and legislation to introduce a first-to-file system is currently pending in the Philippines. Canadian government officials have noted that they did not experience any of the negative consequences that some predicted would follow the adoption of a first-to-file system.

b. Premature Filings

A first-to-file system will encourage early filing of patent applications in the United States because delays in patent application drafting and filing risks preemptive filing by others in almost every other country in the world. Rather than being detrimental, early filing of patent applications would benefit the public. Together with early publication of patent applications, a first-to-file system would accelerate the innovation process by promoting early disclosure of inventive activity, timely dissemination of patent information, and avoidance of unnecessary research.

One concern that has been expressed is that better written, more thorough patent specifications are a significant benefit of the first-to-invent system, and that this benefit would be lost in a first-to-file patent system. The theory is that a patent applicant in a first-to-invent system has more time to develop and refine the invention prior to filing, as well as more time to prepare the application. This theory, however, is flawed, given the practical realities of requirements for rapid filing in order to avoid loss of patent rights, both domestically and overseas.

Furthermore, this concern can be addressed fully by implementation of a provisional application system, which will enable inventors to file early, preserve their right of priority to the invention, and then enjoy a full year to complete the requisites of a complete application. In fact, a system which provides this one-year period after establishment of priority should make it easier, rather than more difficult, to provide thorough and complete patent applications prior to the examination of those applications. Finally, the requirements for full written description and enablement of the claimed invention will continue to apply in the same substantive manner in any U.S. first-to-file system.

(c) Record Keeping and Diligence

Non-commercially oriented scientific research entities have argued that they would suffer a disadvantage from loss of equal and assured access to the patent system if a first-to-file system is adopted in the United States, even if a provisional application procedure is provided. Under a first-to-file system, the argument continues that academic researchers

16 *See* Article 12, ***Disclosures Not Affecting Patentability (Grace Period)***, Draft Treaty Supplementing the Paris Convention for the Protection of Industrial Property as far as Patents are Concerned (Draft Patent Law Treaty), WIPO Document PLT/DC/3 of December 21, 1990. It should be noted that publication or other public disclosure of an invention caused independently of the patent applicant prior to the filing date would be considered prior art, and would not be protected by the contemplated "personal" grace period. Only "self-created" prior art would be protected under the first-to-file grace period because, in a first-to-file system, prior art is defined in terms of the filing date of an application, rather than the invention date.

17 *See* Charles L. Gholz, ***How the United States Currently Handles the Interference Issues That Will Remain in a First-To-File World***, 18 A.I.P.L.A. Q.J. 1 (1990).

18 For a comparative survey of prior user rights provisions in foreign countries, see "Prior User Rights", the MEMORANDUM OF INTERNATIONAL BUREAU, pp. 17-18 and Annex II, HL/CE/IV/INGI/2 Rev.1 (English) (May 30, 1980).

19 Under Article 4(B) of the Paris Convention, acts which occur during the Convention priority year (i.e., after the earliest effective filing date of a patent application) cannot give rise to prior user rights. The form of prior user rights provided by a country, if any, is reserved in accordance with its domestic law under Art. 4(b). Hence, while prior user rights provisions have common characteristics, they do vary considerably country by country.

20 *See* Article 20, Draft Patent Law Treaty, ***supra*** note 16.

21 35 U.S.C. § 102(g) (1988).

22 It is said that failure to address the prior user issue was one reason why the 1966 Presidential Commission's recommendation to change to a first-to-file system was never adopted.

23 Opponents of the prior user right note that freedom to practice can be ensured by mere publication, which can be done cheaply, quickly and, if desired, anonymously.

24 Opponents of the right also point out that because the United States has a more litigious society prior user rights litigation could become more common in this country.

25 Proponents also argue that forcing trade secret users to file for patent protection in the U.S. could benefit offshore users in countries where process patent infringement is difficult to prove because of a lack of any discovery mechanism in litigation.

26 Kewanee Oil Co. v. Bicron, 470 U.S. 470, 181 U.S.P.Q. 673 (1974) (the Supreme Court held that Ohio's law of trade secrets was not preempted by the Federal patent laws. The court noted that "trade secret law and patent law have co-existed in this country for over one hundred years. Each has its particular role to play, and the operation of one does not take away from the need for the other.")

27 *See* the discussion regarding deletion of the best mode requirement in Part II.

28 *See* Griffith v. Kanamaru, 816 F.2d 624, 2 U.S.P.Q.2d 1361 (Fed. Cir. 1987) (attempt to finance experimentation does not constitute diligence).

29 35 U.S.C. § 154.

30 The 1966 Commission recommended that the term of a patent whose issuance was delayed by reason of the application being placed under secrecy order should be extended for a period of equal to the delay in issuance of the patent. This change would compensate for the loss of patent term under a system measuring the patent term from the filing date rather than grant date. Of course, this could lead to the situation where a

APPENDIX 8.—DURATION OF PATENTS; MAINTENANCE FEES; PROVISIONAL PROTECTION OF APPLICANT; PRIOR USERS' RIGHTS, AN EXTRACTION FROM THE WORLD INTELLECTUAL PROPERTY ORGANIZATION, COMMITTEE OF EXPERTS ON THE HARMONIZATION OF CERTAIN PROVISIONS IN LAWS FOR THE PROTECTION OF INVENTIONS, FOURTH SESSION, GENEVA, NOVEMBER 2–6, 1987, HL/CE/IV/INF/2 REV., MAY 30, 1988

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WORLD INTELLECTUAL PROPERTY ORGANIZATION
GENEVA

COMMITTEE OF EXPERTS
ON THE HARMONIZATION OF CERTAIN PROVISIONS IN LAWS
FOR THE PROTECTION OF INVENTIONS

Fourth Session
Geneva, November 2 to 6, 1987

DURATION OF PATENTS: MAINTENANCE FEES: PROVISIONAL PROTECTION OF APPLICANT: PRIOR USERS' RIGHTS

Memorandum of the International Bureau

57211/IPD

PART FOUR: PRIOR USERS' RIGHTS

18. Under certain laws, the owner of a patent cannot prohibit the use of the patented invention to a person who has started such use before the filing date or the priority date. Thus, such a "prior user" has a right to continue the use despite the grant of the patent. Under some laws, actual use before the filing date or the priority date is not necessary; mere preparations for use or even "possession" (i.e., knowledge sufficient for use of the invention) is sufficient under those laws. All those cases are covered by the expression "prior users' rights."

19. It is to be noted that a right to use a patented invention means, in the case of a product patent, the right to produce the product and to distribute it and, in the case of a process patent, the right to use the process and--where the applicable law extends process protection to directly obtained products--to distribute products directly obtained from the said process.

20. Annex II contains an analysis of the provisions concerning prior users' rights in those 45 countries in which in 1985 (or in 1984, if statistics for 1985 were not available) the highest number of patents and/or inventors' certificates were granted and under the Agreement Relating to the Creation of an Intellectual Property Organization (Bangui Act) within the framework of the African Intellectual Property Organization (OAPI). The European Patent Convention (EPC) is not referred to since it does not cover this aspect of patent law, leaving it to the national laws of its Contracting States.

21. The relevant information is presented in the form of a table in order to illustrate the existing differences.

22. Out of the 45 countries and one regional patent convention covered in Annex II, 28 countries and the Bangui Agreement provide for some kind of prior users' rights; 12 countries do not provide for any such right, and five countries have particular provisions for the situations which in the first group of countries give rise to prior users' rights.

[The Annexes follow]

TABLE CONCERNING PROVISIONAL PROTECTION OF APPLICANT

Country/Regional Treaty	Provisional Protection Between Filing Date and Date on Which Effects of Patent Begin		
	Period Between FD and P1	Period Between P1 and P2	Period Between P2 and DE
OAPI	XXXXXXXXXXXXXXXXX	XXXXXXXXXXXXXXXXXXXXXX	XXXXXXXXXXXXX(1)
Argentina			
Australia		XXXXXXXXXXXXXXXXXX(2)	XXXXXXXXXXXX(2)
Austria			XXXXXXXXXXXXXXX
Belgium (3)	//////////////(1)	////////////////////////	////////////////
Brazil	//////////////(2)	////////////////////////	///////////////(2)
Bulgaria			
Canada			
Chile			
China		///////////////////(2)	/////////////(2)
Colombia			
Czechoslovakia			
Denmark		///////////////////(2)	XXXXXXXXXXXX(2)
Finland		///////////////////(2)	XXXXXXXXXXXX(2)
France	XXXXXXXXXX(1)(2)	XXXXXXXXXXXXXXXXXXXXXX	XXXXXXXXXXXXX(2)
German Dem. Rep. (4)		XXXXXXXXXXXXXXXXXXXXXX	XXXXXXXXXXXXX(2)
Germany, Fed. Rep. of		////////////////////////	////////////////
Greece			
Hungary	XXXXXXXXXXXXXX(2)	XXXXXXXXXXXXXXXXXXXXXX	XXXXXXXXXXXXX(2)
India			XXXXXXXXXXXX(2)
Ireland			XXXXXXXXXXXX(2)
Israel			XXXXXXXXXXXX(2)
Italy	XXXXXXXXXXXXXX(1)	XXXXXXXXXXXXXXXXXXXXXX	XXXXXXXXXXXXXXX
Japan		XXXXXXXXXXXXXXX(5)(6)	XXXXXXXXXXXXXXX
Luxembourg			
Mexico			
Morocco			
Netherlands		////////////////(2)(7)	XXXXXXXXXXXX(2)
New Zealand			XXXXXXXXXXXX(2)
Norway		///////////////////(2)	XXXXXXXXXXXX(2)
Philippines			
Poland	XXXXXXXXXXXXX(2)	XXXXXXXXXXXXXXXXXXXXXX	XXXXXXXXXXXXX(2)
Portugal			

For explanations, see page 2 of this Annex. The footnotes appear on page 3 of this Annex.

Country/Regional Treaty	Provisional Protection Between Filing Date and Date on Which Effects of Patent Begin		
	Period Between FD and P1	Period Between P1 and P2	Period Between P2 and DE
Rep. of Korea		XXXXXXXXXXXXXXXX(6)(8)	XXXXXXXXXXXXXXXX
Romania			
South Africa (9)			XXXXXXXXXXXX(10)
Soviet Union			
Spain	////////////////(11)	//////////////////////////	//////////////////
Sweden		////////////////////(2)	XXXXXXXXXXXX(2)
Switzerland	////////////////////	////////////////////(2)	XXXXXXXXX(2)(12)
Turkey			
United Kingdom		XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX(2)	
United States of A.			
Uruguay			
Venezuela			
Yugoslavia	XXXXXXXXXXXXXXXX(2)	XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX(2)	

Explanations

________	=	no provisional protection
XXXXXXXX	=	protection substantially equivalent to effects of patent
/////////	=	protection not equivalent to effects of patent (e.g., mere right to reasonable compensation)

FD = Filing date.

P1 = Publication of unexamined or not completely (i.e., not covering novelty and inventive step) examined application.

P2 = Publication of application after examination of all formal and substantive grounds.

DE = Date on which effects of patent begin.

Footnotes

(1) If and from the time at which official copy of application is notified to individual user.

(2) Proceedings (or, at least, final decision) possible only after grant of patent.

(3) P1 takes place only at request of applicant.

(4) P1 corresponds to issue of provisional patent.

(5) If and from the time at which individual user received writ of warning or knew of application.

(6) Right cannot be exercised before P2.

(7) Only for acts performed after 30 days from serving writ of warning upon individual user.

(8) If and from the time at which individual user received writ of warning.

(9) P1 takes place only if application claims priority under the Paris Convention.

(10) Proceedings possible only after nine months from sealing of patent.

(11) If and from the time at which individual user was informed of application.

(12) P2 takes place only for a few specific technical fields.

[End of Annex I:
Annex II follows]

TABLE CONCERNING PRIOR USERS' RIGHTS

Country/ Regional Treaty	Right to Use Patented Invention Based on Possession, Preparations for Use or Use Before Filing Date or Priority Date						
	Facts Giving Rise to Right of Use			Knowledge Must not be Derived From Owner of Patent (or his Predecessor in Title)	Right of Use Limited to		Particu' Provisic
	Possession	Preparations for Use	Use		Scope of Original Use or Preparations	Needs of Own Business	
OAPI		yes	yes			yes	
Argentina							
Australia							
Austria		yes	yes			yes	
Belgium	yes	(1)	yes				
Brazil							
Bulgaria		yes	yes	yes			
Canada							(2)
Chile							
China		yes	yes		yes		
Colombia							
Czechoslovakia		yes	yes	yes			
Denmark		yes	yes		yes		(3)
Finland		yes	yes		yes		(3)
France	yes	(1)	(1)				
German Democratic Republic		yes	yes				

For explanations and footnotes, see page 4 of this Annex.

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Country/ Regional Treaty	Right to Use Patented Invention Based on Possession, Preparations for Use or Use Before Filing Date or Priority Date						
	Facts Giving Rise to Right of Use			Knowledge Must not be Derived from Owner of Patent (or his Predecessor in Title)	Right of Use Limited to		Partic... Provis...
	Possession	Preparations for Use	Use		Scope of Original Use or Preparations	Needs of Own Business	
Germany, Federal Republic of		yes	yes	under certain conditions (4)		yes	
Greece		yes	yes			yes	
Hungary		yes	yes	yes			
India							(5,
Ireland							(5)
Israel		yes	yes			yes	
Italy			yes		yes		
Japan		yes	yes	yes	yes		
Luxembourg		yes	yes				
Mexico		yes	yes				
Morocco							
Netherlands		yes	yes	yes			
New Zealand							(5)
Norway		yes	yes		yes		(3)
Philippines							
Poland		yes	yes		yes	yes	
Portugal							
Republic of Korea		yes	yes			yes	(6
Romania		yes	yes	yes			

For explanations and footnotes, see page 4 of this Annex.

Country/ Regional Treaty	Right to Use Patented Invention Based on Possession, Preparations for Use or Use Before Filing Date or Priority Date						
	Facts Giving Rise to Right of Use			Knowledge Must not be Derived From Owner of Patent (or his Predecessor in Title)	Right of Use Limited to		[illegible]
	Possession	Preparations for Use	Use		Scope of Original Use or Preparations	Needs of Own Business	
South Africa							
Soviet Union		yes	yes	yes			
Spain		yes	yes		yes	yes	
Sweden		yes	yes		yes		
Switzerland		yes	yes			yes	
Turkey							
United Kingdom		yes	[illegible]				
United States of America							
Uruguay							
Venezuela							
Yugoslavia		yes	yes				

For explanations and footnotes, see page 4 of this Annex.

Explanations and Footnotes

"yes" means that the solution indicated in the heading of the table is provided for in the applicable legislation (if there is no "yes" under the heading "Facts Giving Rise to Right of Use", possession, preparation for use or use before the filing date or priority date do not create a right to use the patented invention).

Footnotes

(1) Since possession is sufficient, it is assumed that preparations for use or use create the same right as possession.

(2) Specific articles produced before the grant of a patent may be used and sold also after grant.

(3) Use or preparation for use between priority date and first publication of application may under special circumstances justify a compulsory license.

(4) If the applicant, or his predecessor in title, has, before applying for a patent, disclosed the invention to other persons and reserved his rights for the case that a patent might be granted, any person knowing of the invention because of this disclosure cannot claim a prior user's right relying on measures he has taken within six months from the disclosure.

(5) Use for government purposes is exempted from patent effects if the invention has been recorded or tried, before the priority date, by or on behalf of the government and this was not dependent upon a communication derived from the owner of the patent or his predecessor in title.

(6) Patent effects do not extend to identical products existing in the country at the national filing date.

(7) Secret use on a commercial scale within the country before priority date affects novelty.

[End of Annex II and of document]

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